BRITISH FINANCE

DURING AND AFTER THE WAR

1914-21

BEING THE RESULT OF INVESTIGATIONS AND MATERIALS COLLECTED BY A COMMITTEE OF SECTION F OF THE BRITISH ASSOCIATION

CO-ORDINATED AND BROUGHT UP TO DATE FOR THE COMMITTEE BY

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EDITOR'S PREFACE

THIS volume sums up work that was commenced in the year 1915 by a Committee organized by the Section of Economics and Statistical Science of the British Association. Throughout the war period this Committee, under the Chairmanship of Professor W. R. Scott, F.B.A., of Glasgow, and with Mr. J. E. Allen as Secretary, accumulated a considerable mass of information as to the financial arrangements of the Government, and the course of events connected with Currency and the Exchanges. In order that the information thus collected might be available as soon as possible, four volumes of reports were issued, the first appearing in the year 1916 and the last in 1920. When the last volume was issued, the officials of the Section considered what would be the best course to take, as obviously a good deal of what had been published was fragmentary, and estimated figures, or figures which had been amended, needed to be brought up to date. The work that had to be done was not only great in itself, but required an immense amount of patience, and, above all, experience and knowledge of currency and banking conditions, in order that there might be proper control. Fortunately one of the members, Mr. A. H. Gibson, a well-known authority who had made some valuable suggestions to the Government during the war, very kindly offered to co-ordinate and make the necessary corrections. He had collected further information which would enable him to bring the whole of the work up to date. It was decided to accept this exceedingly generous offer, and Professor Scott as Chairman, with the Editor, were asked to see to the passing of the proofs through the Press. The Section owes Mr. Gibson a deep debt of gratitude. He has put into clear and chronological form a very great amount of information, some of which might have been lost, most of which would have been very difficult to obtain. It is all in this volume readily available and easy to understand in its full significance. The story extends from the outbreak of the war to the summer of 1921, and I doubt whether any other of the economic spheres

of the war period with the exception of industry has been reduced to a well-ordered or intelligible form comparable to this.

In a companion volume, Miss Ashley and Miss Grier have told the story of the replacement of men by women and of the gradual reinstatement of men after the war. These two records should prove of inestimable value, not only to contemporary investigators, but to economists, bankers, and social workers for many generations to come.

To Mr. Gibson, those who are responsible for this volume wish to render their deep sense of gratitude for the many months of patient toil that he has given to a labour of love.

A. W. KIRKALDY.

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BRITISH FINANCE, 1914-1921

CHAPTER I

SUMMARY OF THE MORE IMPORTANT EVENTS AND EMERGENCY MEASURES DURING THE EARLY MONTHS OF THE WAR

IN the early summer of 1914 credit in Great Britain and on the Continent was normal, with perhaps a tendency towards uneasiness. The extreme fluctuations in the price of Consols for the year 1913 were 75¾–71, and the closing price on 25th June, 1914, was 74¾–75, a price well over the average of the previous year. Early in July there were signs of caution in the chief money markets, following the assassination of the Archduke Francis Ferdinand at Sarajevo, on 28th June. The progress of negotiations between Austria and Serbia produced little effect, and even the presentation of Austria's ultimatum to Serbia on 23rd July did not cause any marked uneasiness in London, as it was the general impression that if war broke out it would be localized. On the 25th there was a panic on the Vienna Bourse, and in London Consols fell to 72¼. Between that day and the following Tuesday (28th), when Austria declared war against Serbia, was a time of growing anxiety. In the week ending on the 29th (Wednesday), Consols had fallen 4½, Belgian 3 per Cents. 4¾, French 3 per Cents. 6, Russian 3½ per cent. Bonds 5, Russian 5 per Cents. (1908) 8½, Austrian 4 per Cents. 8.

By this time all the Stock Exchanges had closed except London and the provincial Exchanges, New York, and the official (parquet) Paris Exchange. The English Bank Rate was raised from 3 per cent. to 4 per cent. on Thursday, the 30th. Remittances of all classes due from abroad practically ceased except from America, and the closing of all the Continental Stock Exchanges except

the official Paris market caused large quantities of International stocks to be offered for sale in London. It so happened that this period of extreme tension coincided with the date fixed for the Stock Exchange settlement, which had been arranged for 27th–29th July. The failure or inability of foreign clients of brokers to remit the sums due in London for the settlement made the position of these brokers precarious, and one important firm with foreign connections failed, while it was currently reported that many firms were prepared to hammer themselves. The failure of foreign remittances to the Stock Exchange affected transactions made before the crisis.

After the outbreak of hostilities with Serbia, there was a steady pressure of sales from the Continent. The effect of these was a reduction in the prices of securities, which fall at once reacted on those stocks held on margin. Loans on Stock Exchange securities at this period amounted to about £80,000,000, one-half of which was lent by the Joint Stock Banks. A continued fall in quotations would cause margins to disappear, and, therefore, the lenders would call for additional security, or they might call for repayment of the loans when due through anticipation of having to meet pressing demands themselves. The latter course was adopted by some lenders, which action threatened a further fall in the prices of stocks. If demoralization in the Stock Exchange was to be avoided, some action had to be taken on Thursday, the 30th, and it was decided on that day to close the Exchange, after the finish of business for the day.

The closing of the London Stock Exchange was the first of the series of Emergency Measures ; and, to some extent, it influenced those that followed. Prompt and decisive action was absolutely necessary ; but, had time for reflection been available, it is possible that less drastic measures would have sufficed. The closing of the Exchange was not the only event of first-class importance on that memorable Friday. Bill-brokers, for the conduct of their business, borrow large sums from the Joint Stock Banks on the security of bills. During this week some of the banks called in their loans from the bill-brokers, who were forced to have recourse to the Bank of England, either to borrow therefrom or to discount thereat bills they held in their portfolios. The sums involved were large

In pre-war normal times it was estimated that the Joint Stock Banks lent about £100,000,000 to bill-brokers at call or at short notice. In the ten days ending 1st August, the Bank of England's holding of "Other Securities" increased by £31,700,000, the greater part of which was understood to have represented loans to the bill-brokers to enable them to meet the calls made on them by the Joint Stock Banks. These great demands on the Bank of England were one cause of the rapid rise in Bank Rate, which, after being 4 per cent. for one day (Thursday, 30th July) was doubled on Friday, and further increased to 10 per cent. on Saturday, 1st August.

The enormous strain felt by the Bank of England during the last few days of July is clearly shown by the letters which passed between the Bank of England and the Treasury on 1st August, copies of which appear below and on the next page.

(I)—Letter from the Bank of England to the Chancellor of the Exchequer, Dated 1st August, 1914.

1st August, 1914.

Sir,

We consider it to be our duty to lay before the Government the facts relating to the extraordinary demands for assistance which have been made upon the Bank of England in consequence of the threatened outbreak of hostilities between two or more of the Great Powers of Europe.

We have advanced to the Bankers, Bill Brokers and Merchants in London during the last five days upwards of Twenty-seven Millions Sterling, upon the security of Government Stock, Bills of Exchange, etc., an unprecedented sum to lend, and which, therefore, we suppose, would be sufficient to meet all their requirements; although the proportion of this sum which may have been sent to the country must materially affect the question.

We commenced this morning with a reserve of £17,420,000, which has been drawn upon so largely that we cannot calculate upon having so much as £11,000,000 this evening, making a fair allowance for what may be remaining at the Branches.

We have not up to the present refused any legitimate application for assistance, but having regard to the depletion of the reserve, we fear that unless we obtain authority to issue Notes against Securities in excess of the amount permitted by law it will shortly become necessary to curtail the facilities which under present conditions we regard it as essential to offer to the trade and commerce of the country.

We have the honour to be, Sir,
Your obedient Servants,

(Signed) Walter Cunliffe.
(Signed) R. L. Newman.

The Right Honourable
The Chancellor of the Exchequer.

(II).—Letter from the Prime Minister and Chancellor of the Exchequer to the Bank of England, dated 1st August, 1914.

Treasury Chambers, Whitehall, S.W.
1st August, 1914.

Gentlemen,

We have the honour to acknowledge the receipt of your letter of this da to the Chancellor of the Exchequer in regard to the extraordinary demands which are being made upon the Bank of England in consequence of the threatened outbreak of hostilities between two or more of the Great Powers of Europe.

In the circumstances represented, His Majesty's Government recommend that, if the Bank of England shall find that, in order to meet the wants of legitimate commerce, it is requisite to extend its discounts and advances upon approved securities so as to require issues of Notes beyond the limit fixed by law, this necessity should be met immediately upon its occurrence, and in that event they will not fail to make application to Parliament for its sanction.

No such discount or advance should be granted at a rate of interest less than 10 per cent., and His Majesty's Government reserve it to themselves to recommend, if they should see fit, the imposition of a higher rate.

After deduction, by the Bank, of whatever it may consider to be a fair charge for its risk, expense, and trouble, the profits of these advances will accrue to the public.

We have the honour to be, Gentlemen,
Your obedient Servants,
(Signed) H. H. Asquith.
(Signed) D. Lloyd George.

To the Governor and Deputy Governor,
Bank of England.

Concurrently with the difficulties of the bill-brokers, there were the even greater ones of the accepting houses. These institutions in effect guarantee that a foreign bill (arising out of a trade transaction either between this country and a foreign country, or between two foreign countries) will be met at maturity. It is largely this form of finance that made London the financial centre of the world, and it was estimated in pre-war times that one-half of the world's foreign trade was financed by British credit. The acceptances of the accepting houses and foreign banks current at this period in London amounted to between £300,000,000 and £350,000,000, and those of the Joint Stock Banks to about £70,000,000.

The position of the accepting houses was rendered very precarious because foreign remittances to meet the acceptances were not forthcoming, or were delayed, or could only be made with great difficulty. London, early in the crisis, began to call in credit from all quarters, and as a consequence all available bills on London were quickly purchased by foreign debtors for transmission to

London. New bills were not forthcoming, and there were great difficulties in procuring gold abroad for shipment to this country; in some cases it was impossible. In these circumstances, the position of the accepting houses was one of extreme hazard, and it may truly be said that the immediate effect of the outbreak of hostilities was to break down the whole fabric of foreign exchange throughout the world.

On Sunday, 2nd August, a Proclamation[1] was issued which postponed payment of bills of exchange (other than a cheque or bill on demand) if accepted before the 4th of August for a period of one calendar month from the date of its original maturity. On Monday, 3rd August, an Act, known as the Postponement of Payments Act (4 & 5, Geo. 5, c. 11)[2] was passed, which authorized the King to suspend temporarily by proclamation other payments besides bills of exchange.

So far, the dramatic events of Friday, 31st July, and Saturday, 1st August, have been considered from the point of view of the reaction of the crisis on credit as regards foreign remittances. There remains the position in relation to internal credit.

It appears that the Joint Stock Banks, or some of them, expected and prepared for considerable demands from their depositors, but the attitude of the British public during the early stages of the crisis proved that the loss of public confidence was extremely slight. There was no run on the Joint Stock Banks nor on the Savings Banks, and what degree of hoarding of gold took place at the commencement of the crisis was probably due to the lead given by some of the Joint Stock Banks paying out Bank of England notes instead of gold. This action caused a large number of people to whom notes had been paid, to take them to the Bank of England to change them into gold, which was required for holiday purposes. Almost without exception the reports of the Savings Banks for the year 1914 proved how trivial had been the influence of the crisis on their accumulated funds, the main influence exerted having been a slight check to new business. There was a somewhat general apprehension prior to the issue of Currency Notes that where a creditor insisted on payment in the form of legal tender, there might not be sufficient legal tender to meet all demands.

[1] For copy of Proclamation *see* Appendix I (*a*).
[2] For copy of Act *see* Appendix II (*a*).

The Bank of England lost £1,213,000 in gold to the Provinces during the week ending 29th July, and £8,211,000 [1] during the next week, which included the days during which mobilization took place.

On 1st August, Germany declared war on Russia, and on the next day a state of war existed between Germany and France. War between Great Britain and Germany was declared on Tuesday, 4th August. Prior to the latter declaration, which might be expected to have affected the London money market most, there had been the complete breakdown of the foreign exchanges and the closing of the Stock Exchange. It had been necessary, as already stated, to support the accepting houses by the Moratorium in their favour of 2nd August. Scarcity of legal tender was felt, and there was apprehension in many quarters that war between this country and Germany would result in further grave disorders of credit. This was the situation which had to be faced on Sunday, 2nd August, and Monday, 3rd August. Fortunately, the Monday was a Bank Holiday, and by proclamation the Tuesday, Wednesday, and Thursday were appointed special Bank Holidays, thus providing five days (if the Sunday be included) for the preparation of further emergency measures. An Act, known as the Currency and Bank Notes Act (4 & 5, Geo. 5, c. 14),[2] was passed on 6th August, authorizing the Treasury to issue Currency Notes for £1 and 10s. as legal tender for any amount. The holder of a Currency Note was, and still is, entitled to obtain on demand at the Bank of England, London, payment for the note at its face value in legal tender gold coin. It was also provided that Postal Orders were to be temporarily legal tender for the payment of any amount. This provision was revoked as from 3rd February, 1915, by proclamation. Under Clause 3 of the Act, the Bank of England and any Scottish or Irish Bank of Issue might issue notes in excess of the limit fixed by law so far as temporarily authorized by the Treasury, and subject to any conditions attached to that authority. Banks of Issue were indemnified against any liability on the ground of excess of issue after 1st August, 1914, in pursuance of any authority from the Treasury. For a very short time the Bank of

[1] A large part of this sum would be held by banks in anticipation of heavy withdrawals by their depositors, partly for holiday requirements.

[2] For copy of Act, *see* Appendix III (*a*).

England did exceed the issue limit of uncovered notes fixed by the Bank Act of 1844. Currency Notes were issuable to bankers through the Bank of England up to 20 per cent. of their liabilities on deposit and current accounts.

Closely connected with these measures was the Proclamation[1] of 6th August, under the Act 4 & 5, Geo. 5, c. 11, postponing other payments besides bills of exchange until 4th September, 1914 (subsequently extended until 4th November[2]), with certain exceptions, the chief of which were payments of wages or salaries, sums not exceeding £5, dividends on trustee stocks, cashing of bank notes by the issuing banks, and payments by Government Departments (including Old Age Pensions and liabilities under the National Insurance Act). Bank rate was reduced from 10 to 6 per cent. on 6th August, and to 5 per cent. on 8th August.

These measures paved the way for the re-opening of the banks on Friday, 7th August, upon a basis which, if artificial, was believed to have protected the banks. In making the first steps towards more normal conditions, it was necessary that the machinery of the foreign exchanges should be restored without delay and the Stock Exchange re-opened. As regards the former, exchange transactions in the early days of August were remarkable. The value of the sovereign rose as much as 30 per cent. in a single day in New York. On the other hand, owing to a temporary adverse balance due to France, the sovereign depreciated in Paris by 4 per cent.

On 13th August it was announced[3] that the Bank of England, under Government guarantee against loss, would discount at Bank Rate, without recourse to the holders, all approved bills accepted before 4th August, and that acceptors of such bills discounted at the Bank of England might postpone payment at maturity by paying interest at 2 per cent. above Bank Rate varying. About three weeks later, on 5th September, the Government announced[4] that the Bank of England would provide acceptors with funds to pay all approved pre-Moratorium bills at maturity. The Bank was entitled to interest on these advances at 2 per cent. above Bank Rate, and undertook not to claim repayment of any sums not recovered by acceptors from their clients until one year after

[1] For copy of Proclamation, *see* Appendix I (*b*).
[2] For copy of Proclamations, *see* Appendix I (*d*) and (*e*).
[3] For copy of announcement, *see* Appendix II (*b*).
[4] For copy of announcement, *see* Appendix II (*c*).

the end of the war. The Joint Stock Banks undertook, with the assistance of the Bank of England and the Government, to finance new bills upon similar terms. The Government guaranteed the Bank of England against any loss which it might eventually sustain in carrying out this scheme. This guarantee later received statutory sanction by the Government War Obligations Act, 1914 (5 Geo. 5, c 11),[1] passed on 27th November. Loans to the Stock Exchange were next taken in hand. Under a scheme for Government assistance, dated 31st October, as regards Account to Account Loans which had been made on the security of stocks by lenders, other than banks to whom currency facilities were open, or members of the Stock Exchange, the Government arranged with the Bank of England to advance 60 per cent. of the sums outstanding on 29th July, securities being valued for purposes of such advance at the making-up prices of 29th July. The Bank undertook not to press for repayment until twelve months after the conclusion of peace, the rate of interest being 1 per cent. above Bank Rate, with a minimum of 5 per cent. The Banks to whom currency facilities were open undertook not to press for repayment of Account to Account Loans, nor to require further margin, until twelve months after the conclusion of peace. The total advances on foreign bills under the Government Guarantee were £120,000,000. The sum advanced on pre-Moratorium bills to enable acceptors to meet their engagements at maturity was £60,386,000, and it was estimated that at the end of the war, bills aggregating to £50,000,000 would remain in "cold storage."[2] The advances by the Bank of England to the Stock Exchange under the Treasury scheme of 31st October were returned at £520,059.[3] The way was now prepared for completing the July settlement of the Stock Exchange, and a patched-up settlement was effected on 18th November. Meanwhile, though the Exchange remained closed, dealings in stocks had been effected by negotiation, and a scale of minimum prices had been drawn up by the Committee. The general Moratorium having come to an end on 4th November, there was no further reason to delay the opening of the Exchange, and this event took place on 4th January, 1915, under somewhat drastic regulations imposed by the Treasury.

[1] For copy of Act, *see* Appendix V.
[2] Hansard, Commons, lxviii, p. 1545.
[3] *Ibid.* lxxi. p. 853.

CHAPTER II

A REVIEW OF GOVERNMENT ASSISTANCE TO BANKS AND FINANCIAL HOUSES AT THE OUTBREAK OF WAR

In the previous chapter brief reference was made to the various financial measures passed by the Government in the early stages of the war. In the present chapter these measures are discussed in greater detail, and in particular in their relation to Banks and Financial Houses. Towards the end of the chapter some criticism is expressed as to whether all the measures were really necessary or not.

The main purpose of the Government's financial measures at the outbreak of war was to prevent a serious derangement of credit, and later, to impart a momentum to its machinery which would enable it to resume its operations. As has been already shown, the banks were largely dependent on the accepting houses and the bill-brokers, the bill-brokers were dependent on the accepting houses, and the accepting houses were dependent on their foreign correspondents, who were, owing to the breakdown of the exchanges, unable to send the expected remittances.

The first measure put into force was the Bill Moratorium, proclaimed on Sunday, 2nd August, 1914, and subsequently extended. This proclamation enabled acceptors to postpone for a month payment of any bill accepted before 4th August on re-acceptance for the amount plus interest to the new date of payment at the Bank Rate current on the date of re-acceptance. The proclamation gave breathing time to acceptors who were unable, for various reasons, to take up their maturing acceptances, and consequently prevented a long chain of bankruptcies.

The next steps taken were designed to restore confidence among the banks, who have always on deposit with them large sums of credit withdrawable at call or short notice. The Government protected them by three important measures, which were very effectual in giving new confidence to the banks and the public—

(*a*) The General Moratorium proclaimed on 6th August, 1914, and subsequently extended, gave the banks and other debtors

(with certain exceptions) power to suspend payment for one month of debts payable before the date of the proclamation. But Bank Notes and Currency Notes were convertible into gold during the Moratorium, being specially excluded.

(*b*) The Currency and Bank Notes Act of 6th August, 1914, authorized the Treasury to suspend the Bank Act if necessary. An unlimited amount of Bank Notes would then have been available if required. The Bank Act was suspended, but only for a very short period of time.

(*c*) The same Act also empowered the Treasury to issue £1 and 10s. Currency Notes, which were to be legal tender in the United Kingdom. In a memorandum issued by the Treasury it was announced that Currency Notes would be issued through the Bank of England to bankers as and when required up to a maximum limit not exceeding, in the case of any bank, 20 per cent. of its liabilities on deposit and current accounts, in the form of an advance by the Treasury, the security being a floating charge on the bank's assets in priority to all other charges, bearing interest from day to day at the current Bank Rate. By this measure the banks were placed in the position of being able to obtain, if required, an advance of 225 millions of legal tender currency. In the initial stages of the crisis the banks took nearly 13 millions, but this amount was quickly reduced, the advances outstanding on 30th September 1914, only amounting to £381,500. To give time for the Currency Notes to be printed, August Bank Holiday was extended for the four days, Monday, 3rd August, to Thursday, 6th August, 1914, inclusive.

With the object of placing the bill market again in a position to entertain new business, and thus provide international currency, the Government on 13th August, 1914, announced that the Bank of England, under Government guarantee against loss, would discount at Bank Rate, without recourse to the holders, all approved bills accepted before 4th August. It was also announced that the acceptors of such bills discounted at the Bank of England might postpone payment at maturity by paying interest at 2 per cent. above Bank Rate varying. The effect of this measure did much to restore British credit abroad. The banks immediately sent large parcels of bills for discount to the Bank of England. New bills accepted after the Moratorium, however, came forward slowly. Acceptors

were not very willing to be drawn on except when the bills were drawn against goods consigned to England, because, so long as the exchanges were not working freely, there was still the danger of non-receipt of foreign remittance at date of maturity. The banks also showed disinclination to buy new bills from the brokers.

The Chancellor of the Exchequer, in a speech on 27th November, 1914, stated that the total amount of bills discounted under the Government guarantee had been £120,000,000. (This proved that of the £350,000,000 to £500,000,000 amount of bills which were outstanding at the outbreak of war most had been disposed of in the ordinary course.)

On 5th September, 1914, the Government announced that the following important arrangements had been made with the Bank of England—

(*a*) The Bank of England will provide (where required) acceptors with the funds necessary to pay all approved pre-Moratorium bills at maturity. This course will release the drawers and endorsers of such bills from their liabilities as parties to these bills, but their liability under any agreement with the acceptors for payment or cover will be retained.

(*b*) The acceptors will be under obligation to collect from their clients all the funds due to them as soon as possible, and to apply those funds to repayment of the advances made by the Bank of England. Interest will be charged upon these advances at 2 per cent. above the ruling Bank Rate.

(*c*) The Bank of England undertakes not to claim repayment of any amounts not recovered by the acceptors from their clients for a period of one year after the close of the war. Until the end of this period the Bank of England's claim will rank after claims in respect of post-Moratorium transactions.

(*d*) In order to facilitate fresh business and the movement of produce and merchandise from and to all parts of the world, the Joint Stock Banks have arranged, with the co-operation, if necessary, of the Bank of England and the Government, to advance to clients the amounts necessary to pay their acceptances at maturity where the funds have not been provided in due time by the clients of the acceptors.

The arrangements announced on 5th September, 1914, had

afterwards a most important influence in rehabilitating the bill market and the exchanges.

The measures enumerated above restored confidence among the banks, who had standing over them the possibility of a general run from their depositors at a time when they were unable to convert any large part of their resources into legal tender currency. Unfortunately, in the initial stages of the crisis some of the Joint Stock Banks attempted to hoard their gold stocks at a time when the public wanted gold for holiday requirements. They paid out Bank of England Notes instead of gold. This action caused a large number of people to whom notes had been paid to take them to the Bank of England to change them into gold, which was required for holiday purposes. But apart from this seasonal demand, evidence later became available that there was practically no abnormal desire for gold by the public in the early stages of the crisis, with a few ignominious exceptions. During the week ending 5th August, 1914, the Joint Stock Banks withdrew large amounts of gold and Notes from the Bank of England, where the Reserve fell during this week from £26,875,194 to £9,966,649—a difference of nearly £17,000,000.

For the rapid restoration of confidence among the banks the Government measures must be considered as having been very effective. In the absence of legislation providing that bank deposits over a certain amount should not be withdrawable without a certain notice first being given by the depositor, some measure of protection to banks was necessary in order to restore confidence among the banks. So far, however, as the public were concerned, the experience of the banks later showed that the protective measures enumerated were unnecessary. If there had been no extension of the Bank Holiday, and the banks had not refused to pay out gold to their depositors in the ordinary course of business, there is no reason to think that gold withdrawals from the banks would have been on a very abnormal scale. There would possibly have been a few extra millions paid out during August, but the drain could easily have been met without much effect on current stocks. The issue of Currency Notes, however, at a later date, would, in any case, have been inevitable,[1] to meet the internal

[1] Mr. J. E. Allen does not consider that an issue of Government paper money was inevitable.

demand for increased currency due to the great rise in prices, and in order to release gold for export purposes.

Notwithstanding that there was no public demand for gold for hoarding purposes in the early stages of the war, there was, nevertheless, a gradual internal absorption, the Bank of England losing to provincial circulation the very large amount of £21,936,000 in gold between 29th July, 1914, and 28th July, 1915. Part of this absorption was due to the holding of additional currency stores by the banks and part to the increased currency requirements consequent on the extensive military mobilization and the increased prices of commodities. If the public had been hoarding gold to any large extent, one would naturally expect the Savings Banks to have experienced an abnormal amount of withdrawals since the commencement of the crisis. The reports, however, of the Savings Banks for the year 1914 proved, almost without exception, how trivial had been the influence of the crisis on their accumulated funds, the main influence exerted having been a slight check to new business.

Though it has to be admitted that the emergency financial measures passed by the Government in the early stages of the crisis restored confidence among the banks, yet they had their serious drawbacks. They tended to destroy confidence among the public. The old proved banking maxim that "the best way to restore confidence among depositors is to pay out smilingly in full the demands of any uneasy depositors," and "every restriction on gold going out acts as a restriction on it coming in," were evidently early forgotten by the Government and the banks. The measures caused at the time a loss of confidence in the banks by certain people who can never be expected to understand the machinery of finance. The position of the banks and the fears it engendered during the early days of the crisis proved that in future there must always be available large stocks of paper emergency currency for times of crises, and the banks and other people must be in a position to obtain supplies on pledge of Government securities.

The use of Postal Orders in the early stages of the crisis as legal tender (permitted by the Currency and Bank Notes Act, 1914) was very small. By most people the concession was welcomed as an opportunity for securing a convenient means of remittance for small amounts without paying the usual poundage. The facilities

may have been useful, and no objection can be taken to the measure. After a time the concession was withdrawn.

The Moratorium, however, was a very serious innovation in British finance, and can only be justified by the very serious character of the crisis it was designed to meet. Undoubtedly it was useful in giving people time to think, and to gather together their resources. But, as actually construed by successive Proclamations under the Postponement of Payments Act, it showed certain defects. While it may have served to allay panic, and perhaps even to restore confidence, in the nature of things it could not re-establish credit, for credit is a matter of trust, rather than of calculation. The Moratorium was unsatisfactory in several ways. It extended the time for the execution of contracts involving the payment of certain kinds of debts, but not the time for the execution of contracts involving the delivery of goods or the rendering of services. Many business houses that were under contract to deliver goods at stated intervals against payment on specified dates broke their contracts and refused to continue delivery, unless they could be assured that punctual payment would follow in due course. Thus, a want of confidence, which in the first instance was confined to monetary transactions, was extended to dealings in goods. The same difficulty did not arise to any serious extent with regard to the rendering of services, because payments in the nature of wages or salaries were exempted from the provisions of the Moratorium ; but those who were under liability to pay out large sums in wages were gravely inconvenienced, and sometimes obliged to suspend operations altogether.

CHAPTER III

THE EFFECT OF WAR ON CREDIT

HAVING traced, descriptively, the external results of the earlier months of the war on credit, in the present chapter some general observations are made on the effect of a state of war, of the magnitude of the recent struggle, on credit, considered as far as possible in isolation from emergency measures. From the point of view both of practical finance and of economic theory, the consequences of a remarkable and sudden strain upon credit are of surpassing interest.

The recent war occasioned considerably greater disturbances to credit than previous great wars, owing to the long period of cessation from contests between great Powers and the more highly developed organization of modern credit. From the standpoint of the economist it is unfortunate—while from that of the citizen it may have been fortunate—that complete materials for the observation of the unmitigated effects of the recent war upon credit were largely modified by counteracting influences, many of which were deliberately designed to counteract the direct consequences of hostilities as affecting the credit system in this country. In particular, as already shown, the closing of the Stock Exchange took place before Great Britain was involved in war. Accordingly, direct observation of the exact effects of the recent war on credit cannot be made with completeness ; only such results can be recorded as were disclosed during the disturbance.

Credit is an organic growth. The normal condition assumes a certain degree of stability in the environment in which it works. In the usual credit cycle, though conditions vary as between the maximum and the minimum points of expansion, in both a great number of the factors which affect the calculations of business men remain the same or are altered only to a very slight extent. War on a large scale either changes all conditions or (what is temporarily of equal importance concerning credit) it gives rise to the fear that all conditions may be altered. On the material side, war makes great inroads into the store of commodities and many calls on

services, while it deflects a large amount of labour from productive to destructive purposes. Credit assumes that goods will be brought to market, or be produced in due time, and sold, and that securities, which in reality have their capital values based on future productive power, will not materially fall in current market values through lack of confidence in future production. War materially weakens both these assumptions. When war shakes the foundations of confidence, it is evident that it must immediately cause a serious restriction in the mobility or transfer of credit, and consequently reduce, for the time being, the rate of current and future production, for production cannot obviously be carried on without the transfer of credit. The community consequently suffers through the restriction of credit.

Allusion has already been made to the difficulties of the accepting houses, the bill-brokers, and the Stock Exchange. These reacted on the resources of the Joint Stock Banks, for the effect of the war was to solidify assets hitherto regarded as liquid. The financial life of the City appeared in danger of being frozen at or near its source. This was not so in reality, for the ultimate basis of credit is the future goods and services which can be relied upon to come to market later. Not only does war make it uncertain that some of the anticipated future production will reach the market, but it also makes a violent alteration in the relative values of capital goods and consumable goods. For the purposes of war only the right to goods, consumable now or soon, is useful. Thus, there is inevitably a double revolution in credit occasioned by war, first in the widespread falsification of anticipations, and secondly in the valuation of immediate consumable commodities. Both tendencies arrest the mobility of credit instruments; and some of the credit instruments become temporarily immobile; and, to the extent to which this phenomenon exists, credit temporarily ceases. It is known that the assets which the Joint Stock Banks had available in a comparatively mobile form—consisting of the gold and Bank of England Notes which they held in their strong-rooms and tills and balances at the Bank of England—did not exceed 15 per cent. of their liabilities to depositors. Loans at call or short notice were largely uncallable. Stock Exchange securities held either as investments or collateral security were to a considerable extent unsaleable. During the first week they were altogether

unsaleable except at a dangerous sacrifice. Bills of exchange in the banks' own portfolios might or might not be met at maturity, and bills which the banks had themselves accepted might have to be met out of the banks' own resources. Thus, a large part of bankers' resources were in danger of becoming immobile and solidified.

Briefly, it may be said that there were four main causes which combined to "immobilize credit" at the outbreak of the war—

1. The fear by borrowers that they might have to repay immediately large amounts of credit which the lenders had transferred to them previously on condition that it was withdrawable on demand. A considerable part of this borrowed credit had been re-transferred to others who desired to anticipate the proceeds of future sales or services, and it was not callable immediately.

2. The actual calling in, or attempt to call in, by certain banks, financial houses, and other institutions, of large amounts of credit lent on demand.

3. The general fear (until Currency Notes were issued) that, if the lender insisted on the borrower repaying credit in the form of legal tender currency, there might not be sufficient legal tender to meet all demands.

4. The inability of foreign correspondents, owing to the collapse of the exchanges and for other reasons, to remit credit to this country to meet maturing liabilities and other demand calls.

In the previous chapters there was discussed the effect of the emergency measures. These aimed at re-establishing confidence, and they succeeded in restoring the mobility of many forms of credit immobilized at the outbreak of war. The progress towards a return to normal credit was marked by the gradual recall of successive emergency measures. The main characteristic of credit in this country is its spontaneous character, and necessarily as long as artificial and extraneous devices were required, the position was something intermediate between confidence and credit in the fullest sense of the word. When credit is sound, just as in the case of a healthy man, it does not need tonics, nor is it conscious of its own state. It works largely intuitively. All questioning, even a demonstration of "its inherent soundness," is evidence that there is some danger of a failure of complete confidence at one or more points. The sound state of credit is that which needs no external help.

So far no reference has been made to the general effects of public demands on credit. Bearing in mind that credit is based on claims to goods or services which the community already has at its command, or on the prospective delivery of goods or services, or on the current market capital values of the future powers of production, one resultant effect of increased taxation and extensive Government borrowing due to war conditions must be to reduce, or to cause a reduction in the rate of former increase of, the total credit basis of a nation, more particularly for the following reasons—

1. Government requisitions in the form of immediate taxation means that the community has to give to the Government, without consideration, goods and services which would otherwise be largely used as a basis for credit and to anticipate the proceeds of future production and services, some of which credit would, under peace conditions, have been loaned to foreign and Colonial countries. Immediate taxation, that is to say the compulsory immediate giving of goods and services to the Government, does not bestow on those taxed any lien on the proceeds of future goods and services. Moreover, some of the repairs that may be needed to the sources of production to maintain them at their highest possible output may not be effected, and, if so, the future basis of credit will not be so great as it would have been if there had not been any additional taxation.

2. Government borrowing in the form of loans from the community acts on credit in several ways. The interest payable on the loans in future years means increased taxation, and therefore tends to restrict expansion of credit for the reasons stated in paragraph 1. The actual subscription of the loans themselves involves the handing over to the Government consumable goods and services for the destructive purposes of war, in return for which immediate claims the Government gives the subscribers a transferable lien on the proceeds of future goods and services; in other words, on the future productive power and services of the community. Owing to the great demand for the immediate delivery of goods and services, some of the repairs that are needed to the powers of production to maintain them at their highest possible output will not be effected, and the future basis of credit will not be so great as it would have been if there had not been any extensive Government borrowing.

That part of Government borrowing during war that represents loans to foreign and Colonial countries is simply the transfer to the borrowing countries of immediate claims to goods and services in this or other countries in return for securities granting a lien on the proceeds of the future productive power and services of such borrowing countries. Unfortunately, a large part of the British loans made to foreign countries during the recent war will never be recovered. Present indications point not only to loss of interest, but also to loss of capital.

3. Another effect on credit of extensive Government borrowing, owing to conditions of war, is to reduce the mobility of existing credit. That is to say, people who have command of credit are not so disposed, as they are in times of peace, temporarily to transfer their claims to goods or services, or to the delivery thereof, to people who require immediate credit to anticipate future delivery of goods or services. This disinclination to transfer immediate claims is due to, first, the uneasiness felt by the holder that he may have unexpected calls to meet himself, owing partly to the disturbance of credit due to extensive Government borrowing; second, the uncertainty of the due arrival of the promised proceeds of future goods and services.

4. If there be a restriction of credit, or a reduction in its normal rate of expansion, or a reduction in its usual degree of mobility, that is to say its rate of transfer, there will naturally follow a rise in the price that has to be paid to the holders of immediate credit for the use thereof. Extensive public borrowing must, therefore, cause a rise in the interest yield, not only from Government stocks but from general securities and other loans. The rate of interest will rise until the amount of credit available at such rate meets the demand. After a great war, credit will again expand as more and more goods and services become available as a basis, and the rate of interest will then gradually fall to a normal level. Increasing confidence must hasten the fall, for credit will become more mobile with the greater probability of the due arrival of the proceeds of future goods and services.

An instructive illustration of the effects of great public borrowing for war purposes is given by the following table, showing the extent of the fall and rise in British Government credit during and subsequent to the Napoleonic Wars. It is particularly interesting

as illustrating how quickly Government credit was restored after the termination of these terrible wars, and lends support to the opinion that the recent rise in interest rates can be but temporary, and that a rapid fall will take place in the course of a few years—

CONSOLIDATED THREE PER CENTS.

For Period.	Average Price.	Yield at Average Price.
		£ s. d.
1792	84¾	3 10 9
1793	75¾	3 19 2
1794	67½	4 8 9
1795-1799[1]	58⅝	5 2 4
1800-1804	63¼	4 14 9
1805-1809	63	4 15 3
1810-1814	62½	4 16 0
1815-1819	69⅞	4 5 10
1820-1824	78⅛	3 16 9
1825-1829	84¾	3 11 2
1830-1834	85½	3 10 2
1835-1844	92¼	3 5 1
1845-1854	94¼	3 3 8
1855-1864	92⅞	3 4 7
1865-1874	92	3 5 3

(War period, 1793-1815.)

The quick rise in Government credit after the great wars of a century ago terminated, and until the year 1835, explains why the great conversion schemes of 1822, 1824, 1830, and 1844, which involved a material reduction in the rate of interest, passed off so successfully. After 1835, for a period of about forty years, the credit of the nation, as represented by the yield on Consols, became almost stationary, at about £3 5s. per cent. The most important fact, therefore, to be drawn from the above table is that all loans issued during great wars should bear early dates of redemption, to permit conversion to lower rates of interest when warranted by the state of Government credit.

The extent to which the rate of interest rises in a country as a consequence of war conditions is obviously dependent on the total amount of War Loans issued and their dates of redemption. The economic and credit conditions, active and potential, during the recent war were entirely different to those ruling a hundred years ago. The rise in the rate of interest in any country during war

[1] For 1797, yield at average price was £5 15s. 5d.

reflects the summation of the disturbances to credit due to war conditions, and the subsequent fall, after peace is declared, the gradual liquidation of such disturbances.

When considering the matter of the effect on credit of great public borrowing for the purposes of war, it has always to be borne in mind that the total amount expended is not altogether lost to the nation. Part of it is transferred in the form of profit to manufacturers, producers and others engaged on ammunition and other essential war materials, and another part is represented by ammunition and other Government stores which the community has produced by working more strenuously and by overtime at the factories and mills, but by energy which would not have been expended in peace times. But that part which is represented by ammunition and other Government stores the energy to produce which has been diverted from productive industry is, of course, irretrievably lost to the nation, as is likewise that part expended abroad on the purchase of ammunition and other stores required for the prosecution of war.

Finally, one of the unexpected effects on credit of the great amount of public borrowing during the recent war, that is to say the Government's unprecedented consumption of goods and services for war purposes, was very seriously to depress the American rate of exchange against this country, owing to the large purchases of foodstuffs and war stores that had necessarily to be made from America. Much of the burden so thrown on the credit of the United Kingdom was due to purchases made by her Allies but financed by this country.

In the three chapters that have already been written, a more or less chronological review was made of the more important events and emergency measures passed during the early months of the war. A full account was given of Government assistance to Banks and Financial Houses at the outbreak of the war. Reference was also made to the disturbing effects of a great war on the credit fabric of a community. During the second year of the war there was a considerable recall of various emergency measures, as, for instance, the gradual withdrawal of minimum prices for Stock Exchange securities. On the other hand, in certain directions there were further emergency measures, such as the Act for the

restriction of increase of rent for small dwelling houses, and also the restriction of increase of interest upon mortgages of such houses (5 & 6 Geo. 5, c. 97). Then the calling-up of married men for the Army resulted in measures to relieve them, to a certain extent, of their contractual obligations. On the whole, credit in the year 1915 had adapted itself to a state of war, and any alterations which manifested themselves later were necessary to meet the needs of the financial and military situations as they developed. In the following chapters the great changes that took place in currency, banking, and foreign exchange conditions during the course of the war and up to the time of going to press are reviewed at length. Separate chapters are also devoted to a review of War Finance, Price Movements, and the Growth of Inflation. An Armistice was made with Germany on 11th November, 1918, and Peace was signed on 28th June, 1919.

CHAPTER IV

CURRENCY

It has been shown in earlier chapters that the outbreak of war in August, 1914, did not cause any great and sudden demand for currency by the public. There was no run on the banks. Some of the banks, in order to be prepared for all eventualities, attempted to preserve their gold reserves by paying out on 30th and 31st July and 1st August, 1914, Bank of England notes instead of gold. Whatever degree of hoarding of gold by the public took place during the early stages of the crisis, it did not reflect itself in large demands for withdrawal of gold from the banks. Doubtless the public retained in their own hands for some time a large part of the gold already in circulation at the outbreak of the war. There is evidence that the usual flow of gold into the banks was retarded by some slight loss of confidence by the general public, and some aversion to circulate Currency Notes when first issued. Only to this extent can it be definitely asserted that there was some hoarding of gold by the public in the early stages of the crisis.

But notwithstanding that there was no public demand for gold for hoarding purposes in the early stages of the war, there was, nevertheless, a gradual internal absorption, the Bank of England losing to provincial circulation the very large amount of £21,936,000 in gold between 29th July, 1914, and 28th July, 1915. Part of this absorption was due to the holding of additional currency stores by the banks and part to the increased currency requirements consequent on the extensive military mobilization and the increased prices of commodities. If the public had been hoarding gold to any large extent, one would naturally expect the Savings Banks to have experienced an abnormal amount of withdrawals since the commencement of the crisis. The reports, however, of the Savings Banks for the year 1914 proved, almost without exception, how trivial had been the influence of the crisis on their accumulated funds, the main influence exerted having been a slight check to new business.

The main change in internal currency since August, 1914, has been a record expansion of paper issues, with all the attendant evils of inflation. There has also been an enormous expansion in potential currency—bank deposits—which subject is considered at length in the chapter reviewing the Banking Position since the year 1913.

CURRENCY NOTES.—The most important measure effecting the currency of the country that came into operation since the outbreak of the recent war was the Currency and Bank Notes Act (4 & 5, Geo. 5, c. 14)[1] passed on 6th August, 1914, to which reference was made in the first and second chapters. This Act authorized the Treasury to issue Currency Notes for £1 and 10s. as legal tender for any amount. It also provided that Postal Orders were to be temporarily legal tender for the payment of any amount, a provision later revoked, as from 3rd February, 1915.

Clause 3 of Section 1 of the Act provided that the holder of a Currency Note is entitled to obtain on demand, at the Bank of England, payment for the note at its face value in gold coin. Generally speaking, it may be said the public are ignorant of the convertibility of the note into gold, for no statement to such effect has been printed on any of the notes so far issued.

The Currency Note issue has had six distinct uses or effects. First, it has enabled the banks to meet continuous demands for currency by the public, following the continuous rise, more or less, in commodity prices and wages. Second, it has enabled the Bank of England to conserve the gold stocks of the country, part of which has been exported with the object of rehabilitating to some degree, at different times, certain foreign exchanges adverse to this country. Third, by a very unexpected result, it has increased the amount of the cash reserves of the Joint Stock Banks (to which reference is made in the chapter reviewing the Banking Position since the year 1913), notwithstanding there has been an excess withdrawal over deposit of legal tender from the banks since the outbreak of the recent war. Fourth, it has partly provided a cash basis for a very great extension of bank credit. (This use, as is stated elsewhere, has led to monetary inflation on an artificial cash basis.) Fifth, it has provided the Government with a loan of £336,480,633 towards the cost of the war, for to this extent, up to

[1] For copy of Act, *see* Appendix III (*a*).

4th August, 1920, the Government had drawn on the cash reserve balance of the Currency Note Redemption Account and substituted its own obligations. Sixth, it has *tended* to increase the deposits of the banks by the amount of the Government drawings on the cash balance of the Currency Note Redemption Account ; for the drafts drawn by the Government are mainly later paid into the Joint Stock Banks by their customers. This matter is fully explained in the next chapter.

Currency Notes were first issued by the Treasury on Friday, 7th August, 1914. The outstanding issue grew rapidly and continuously until the year 1920, although decreases occurred in some weeks, probably mainly due to variations in Joint Stock Bank reserves, and to the return of currency after holiday requirements. The amount of Currency Notes and Currency Note Certificates outstanding on 4th August, 1920, was £366,679,828. It is not possible to state what proportion of this amount was in active circulation among the general public and what proportion was held by the banks as till money and reserves. Probably, the total outstanding amount is fairly evenly divided between the general public and the banks. Currency Note Certificates are certificates entitling the holder to demand from the Bank of England, acting for the Treasury, the amount of Currency Notes stated thereon. When the banks wish to increase their own reserves of cash, they may take from the Bank of England Currency Notes or Currency Note Certificates, at their option. If they take the latter they may later exchange the certificates for Currency Notes. Whether banks withdraw Currency Notes or Currency Note Certificates from the Bank of England, their balances thereat are debited for the amount, and the cash balance of the Currency Note Redemption Account kept at the Bank of England credited with the same amount. Currency Notes or Currency Note Certificates may be used by the Scottish and Irish banks of issue as cover for their own notes beyond the pre-war authorized limits of issue.

The following table shows the amount of Currency Notes and Currency Note Certificates outstanding, together with the composition of the Currency Note Redemption Account, at yearly intervals since Currency Notes were first issued on 7th August, 1914.

CURRENCY NOTES OUTSTANDING AND REDEMPTION ACCOUNT

At	Notes and Certificates Outstanding.	REDEMPTION ACCOUNT. Gold Coin and Bullion.	Ratio of Gold and B. of E. Notes to Currency Notes	Government Securities.	Balance at Bank of England.
1915.	£	£	%	£	£
August 4 .	46,729,640	28,500,000	61·0	9,585,828	7,437,287
1916.					
August 2 .	127,674,408	28,500,000	22·4	92,704,722	8,583,605
1917.					
August 1 .	168,541,536	28,500,000	16·9	141,590,655	5,158,641
1918.					
July 31 .	263,299,933	28,500,000	10·8	240,358,823	5,695,268
1919.					
July 30 .	338,787,087	28,500,000	8·4	323,326,735	3,305,239
1920.					
August 4 .	366,679,828	28,500,000 18,600,000[1]	13·1	336,480,633	268,974
1921.					
4th May .	338,441,875	28,500,000 19,450,000[1] 3,000,000[2]	14·2	302,734,722	132,548

The amount of gold coin and bullion held in the Redemption Account, namely, £28,500,000, has not been increased since 12th May, 1915. An addition of £3,000,000, in the form of silver coin, first appeared in the Account dated 20th April, 1921.

Bank of England Notes first appeared as an item in the Redemption Account in the return for the week ended 6th August, 1919, the amount set aside in that week being £250,000. By 31st December of the same year, Bank of England Notes set aside amounted to £4,000,000; and by 4th May, 1921, to £19,450,000.

Following on a recommendation contained in the final report of the Committee on Currency and Foreign Exchanges after the War (issued on 13th December, 1919), to the effect that the maximum fiduciary circulation of Currency Notes in any year should be the legal maximum for the following year, a Treasury Minute[3] was issued two days later under which such issue was restricted

[1] Bank of England Notes. [2] Silver Coin.
[3] For copy of Minute, *see* Appendix III (*d*).

for the year 1920 to a total of £320,600,000, except in so far as such notes were issued against gold or Bank of England Notes. Under this limiting condition, the maximum fiduciary circulation for the following year, 1921, automatically became £317,555,200. The Committee referred to suggested limitations upon the fiduciary portion of the Currency Note issue with a view to the restoration of the normal arrangements under which demands for new currency operate to reduce the reserve in the Banking Department of the Bank of England. The effect of such limitation will doubtless for many years tend to maintain high Bank Rates. Should the Bank of England not be able to maintain a reasonable percentage reserve itself by additions of gold, it would appear that the limitation on the fiduciary portion of the Currency Note issue will have at times to be temporarily suspended.

The issue of the Treasury Minute above referred to was preceded by an announcement by the Chancellor of the Exchequer in the House of Commons on 15th December, 1919, that he proposed to give immediate effect to the following recommendations contained in the final report of the Committee on Currency and Foreign Exchanges after the War—

(1) The legal tender status accorded to the notes of Scottish and Irish banks as an emergency measure in August, 1914, should be withdrawn, and pre-war conditions restored.

(2) The actual maximum fiduciary circulation of Currency Notes in any one calendar year should be fixed as the legal maximum for the next.

(3) The practice of placing Bank of England Notes in the Currency Note reserve, as cover for the note issue, should, as opportunity arises, be continued. (The Chancellor announced that it was his intention to continue this policy.)

(4) The Treasury Minute made under Section 2 of the Currency and Bank Notes Act, 1914, providing for the issue on loan of Currency Notes to joint stock banks, should now be withdrawn.

It will be observed from the following table that the greatest increase in the amount of outstanding Currency Notes and Currency Note Certificates took place during the fourth year of war, but the greatest percentage increase during the second year of war.

ANNUAL INCREASES IN THE AMOUNT OF CURRENCY NOTES AND CURRENCY NOTE CERTIFICATES OUTSTANDING

At	Notes and Certificates Outstanding.	Increase in Amount Outstanding.	Percentage Increase.
	£	£	
1915. August 4	46,729,640	46,729,640	—
1916 August 2	127,674,408	80,944,768	173%
1917. August 1	168,541,536	40,867,128	32%
1918. July 31	263,299,933	94,758,397	56%
1919. July 30	338,787,087	75,487,154	29%
1920. August 4	366,679,828	27,892,741	8%

An interesting feature about the issue of Currency Notes is that the amount of £1 notes outstanding has shown each year an increasing proportion as compared with the outstanding amount of 10s. notes. The amount outstanding of £1 notes increased 115 per cent. during the two years ending 30th July, 1919, but the amount of 10s. notes only 40 per cent. This disproportion of increases is obviously partly due to considerably increased wages and the great rise in commodity prices necessitating people carrying with them for their purchases an increasing proportion of £1 notes. Another factor contributing to the disproportion will be the tendency of banks to keep their reserves in £1 notes rather than 10s. notes, after they have acquired a reasonable quantity of the latter for till purposes. During the year ending 4th August, 1920, there was an increase in the amount of £1 notes outstanding, but a reduction in the amount of 10s. notes.

The increase in the amount of outstanding Currency Notes during the year ending 4th August, 1920, was only £28,812,741, or an increase of 9 per cent. on the amount of such notes outstanding on 30th July, 1919. The outstanding amount of Currency Note Certificates during the same year decreased £920,000.

One reason for the increase in the outstanding amount of Currency Notes during the year ended 4th August, 1920, was the transfer of the major part of the remaining gold reserves of the

Joint Stock Banks to the Bank of England, and their substitution by Currency Notes and Bank of England Notes in the internal reserves of the former banks. Large transfers of gold were made by the Joint Stock Banks to the Bank of England in the early months of the year 1920, the amount of gold held by the Joint Stock Banks at the commencement of that year being estimated at from £35,000,000 to £40,000,000. This centralization of the gold stocks of the country had been strongly advocated during 1918 and 1919.[1]

It would appear that the Currency Note circulation has now reached its maximum amount, and that in future years there will take place a gradual decline in the outstanding amount. A decline will naturally follow the present restriction in bank credit and the limitation imposed by the Treasury Minute of 15th December, 1919, on the fiduciary portion of the issue.

One might have expected some considerable reduction in the outstanding amount, following the severe fall in commodity prices which has been in operation since April, 1920. But the figures given below show little diminution since 31st March, 1920. They indicate, however, a present tendency to reduction.

At	Currency Notes and Certificates Outstanding.
1919.	£
March 26th . . .	328,064,000
June 25th	342,310,000
October 1st . . .	335,021,000
December 31st . .	356,152,000[2]
1920.	
March 31st. . . .	335,372,000
June 30th	357,356,000
September 29th . .	353,795,000
December 29th . .	367,626,000[1]
1921.	
March 30th . . .	343,826,000
June 29th	323,884,000

The reasons why a material decrease has not yet taken place in the outstanding amount of Currency Notes, in sympathy with the fall in prices, may be said to be three, namely: (1) Retail prices

[1] Mr. J. E. Allen disagrees with this policy of centralization.

[2] Increase due to temporary absorption of additional currency for Christmas

have not yet wholly responded to the great fall in wholesale prices. (2) Reductions in wages (up to 4th May, 1921) have not been material. (3) The Joint Stock Banks may be keeping larger amounts of such notes in their own reserves.

Below there is given the Balance Sheet of the Currency Note Account as at 4th May, 1921—

CURRENCY NOTE ISSUE

Balance Sheet, 4th May, 1921

	£		£
Notes outstanding—		Advances—	
One Pound . .	265,897,714	Other Bankers .	
Ten Shilling . .	41,630,891	Currency Note Redemption Account—	
Certificates outstanding	28,770,000	Gold Coin & Bullion .	28,500,000
Total . .	336,298,605	Silver Coin . .	3,000,000
Notes called in but not yet cancelled[1] . .		Bank of England Notes	19,450,000
	2,143,270	Government Securities	302,734,722
Investments Reserve A/c.	15,375,395	Balance at Bank of England . .	132,548
Total . .	353,817,270	Total . .	353,817,270

It will be observed from the above Balance Sheet that no advances to banks were outstanding at the date of making up the Balance Sheet, 4th May, 1921. By a memorandum issued by the Treasury in connection with the Currency and Bank Notes Act of 6th August, 1914, banks were placed in a position to obtain advances from the Treasury in the form of Currency Notes up to a maximum limit not exceeding, in the case of any bank, 20 per cent. of its liabilities on deposit and current accounts. In the initial stages of the crisis the banks took advances for nearly £13,000,000 in the form of Currency Notes, but this amount was quickly reduced. During the greater part of the war, the total amount of such advances outstanding at any time was considerably under £1,000,000. At 1st August, 1917, the amount outstanding was £434,500, and at 30th July, 1919, £480,000. On all such advances made by the Treasury interest had to be paid at current Bank Rate; consequently, the banks found it cheaper to take Currency Notes by drawing on their own balances at the Bank of England. In the

[1] This item has only appeared in the balance sheets since 21st July, 1920, and is generally considered to refer to notes of early issues called in but not at the date of the balance sheet returned to the Bank of England for cancellation, and any such notes held by the Bank of England awaiting cancellation.

early stages of the war, the power to obtain advances from the Treasury up to 20 per cent. of their deposit and current account liabilities admittedly inspired confidence among the banks, as was the intention of the Treasury.

An item in the above Balance Sheet that calls for explanation is the Investments Reserve Account, the amount standing to the credit of this account at 4th May, 1921, being stated to be £15,375,395. This amount represents interest received on all advances made to banks in Currency Notes and on account of the securities held for the Currency Note Redemption Account, a provision made in a Treasury Minute[1] dated 3rd May, 1915.

Since Currency Notes were first issued on 7th August, 1914, their design has been changed twice. The number of forged notes discovered has not been great considering the large amount of notes in circulation. The design and paper of the first notes issued facilitated forgery, in particular the 10s. notes. As notes of a new design were issued, the Treasury cancelled the notes of former issues as returned from circulation. On 11th June, 1920, the Treasury issued an Order[2] calling in Currency Notes of the first and second issues and directing that as from the date of this Order all such notes would cease to be current or legal tender within the United Kingdom. Holders of notes of the first and second series might before 1st September, 1920, exchange such notes at any Money Order Office or at the Bank of England or the Bank of Ireland for notes of the current issue. This Order was later recognized as irregular, for Currency Notes were issued under Act of Parliament, and there is high legal authority for the view that they can only be cancelled in circulation by another Act. The Treasury can withdraw them from circulation, and cancel them as they are withdrawn, but whenever presented they must be honoured. Recognizing this fact after the issue of the Order of 11th June, 1920, the Treasury issued a Minute on 31st July, 1920, which stated that the Chancellor of the Exchequer proposed that on and after 1st September, 1920, provision shall continue to be made whereby the holder of any Currency Notes of the first and second issues may receive in exchange, on application at the Bank of England, but not otherwise, other Currency Notes of the same face value.

[1] For copy of Treasury Minute, *see* Appendix III (*c*).
[2] For copy of Order, *see* Appendix III (*e*).

During the first few months of the war, opinions were freely expressed that the Currency Note issue would have been unnecessary if the banks had continued to pay out gold as formerly. There is much to support this view in the early stages of the crisis, but later developments proved that, sooner or later, an issue of Currency Notes[1] would have had to be made, consequent on the great expansion in bank credit, rapidly increasing commodity prices, and wages. The pre-war amount of internal currency would have proved altogether inadequate to effect every day exchanges of commodities at the higher level of prices. Moreover, it was necessary for the Government and the banks to conserve the gold stocks of the country, in case part of the gold would be later required for export purposes to stabilize certain of the foreign exchanges. As is well known, part of the collected gold was at different times put to this service. Additional currency was also required to meet the needs of mobilization.

That the issue of Currency Notes had been absolutely essential in view of the above conditions was clearly recognized by the Committee on Currency and Foreign Exchanges after the War. From the interim report of this Committee, issued on 29th October, 1918, the following extracts are made—

> The greatly increased volume of bank deposits, representing a corresponding increase of purchasing power and, therefore, leading, in conjunction with other causes, to a great rise of prices, has brought about a corresponding demand for legal tender currency which could not have been satisfied under the stringent provisions of the Act of 1844. . . . Plainly, given the necessity for the creation of bank credits in favour of the Government for the purpose of financing war expenditure, these issues (Currency Notes) could not be avoided. If they had not been made, the banks would have been unable to obtain legal tender with which to meet cheques drawn for cash on customers' accounts. The unlimited issue of Currency Notes in exchange for credits at the Bank of England is at once a consequence and an essential condition of the methods which the Government have found necessary to adopt in order to meet their war expenditure.

GOLD AND SILVER.—It was not to be expected that a great European War could continue for any length of time without having a material effect on the prices of gold and silver, the two metals that before the war were the main constituents of, or basis for, the currencies of the chief countries of the world. The great volume of, more or less, inconvertible paper issues during the war was bound to cause an appreciation in metal values in sympathy with rises in prices of other commodities, and for other reasons.

[1] In the absence of a Bank of England issue of small notes.

The appreciation in the price of gold since the commencement of the recent war has not been as great as in the case of silver, but, nevertheless, it has been very material. The record price of 127s. 4d. per fine ounce was reached on 5th February, 1920, the day following the date (4th February) the New York rate of exchange on London reached its lowest point, namely, 3.21¾. At this price the premium on the normal 77s. 9d. per ounce standard is 50·12 per cent. (Standard gold is eleven-twelfths fine gold, one-twelfth alloy.) Since the record price was reached there has taken place a fall, up to 6th May, 1921, of about 19 per cent., the price on that date being 103s. 4d. per fine ounce. Gold, as is well known, representing the English standard of value, has a very different place in the currency of the United Kingdom than silver. Coins made of the latter metal are token coins, and are only legal tender for a maximum amount of 40s. per transaction. Whatever the weight of gold a person (almost invariably the Bank of England) takes to the Mint to be coined into sovereigns or half-sovereigns, the Mint makes no charge for coining the metal. Every ounce of standard gold makes £3 17s. 10½d. worth of sovereigns or half-sovereigns. If, instead of sending gold directly to the Mint, the owner pursues the customary mode of selling it to the Bank of England, he will receive immediately, according to the Bank Act of 1844, £3 17s. 9d. per ounce, instead of the full Mint price of £3 17s. 10½d. This difference of 1½d. per ounce is to cover loss of interest, and other small charges, which the Bank of England has to bear before it can receive the gold back from the Mint in the form of sovereigns and half-sovereigns.

During the war the gold production of the British Empire was commandeered by the Bank of England (by authority of the Government) at the pre-war price of £3 17s. 9d. per standard ounce. This price restriction was removed on 12th September, 1919. Since that date new gold from the mines has been sold in the open market to the highest bidder, and re-exported when desired, subject to a Government licence. Since the removal of the fixed price for gold bullion, the market price in this country has naturally been largely determined by the course of the New York Exchange rate on London.

Particulars of world gold production since 1891 are shown in a table given in a later chapter reviewing the course of the Foreign

Exchanges since 1914, from which table it will be observed there was a serious shrinkage in the annual production of the metal since 1916.

The rise in the market price of gold made the Government very early in the war declare it illegal for any person to melt up or to sell for a premium gold coins of the realm. It is obvious that if this had not been done a very great temptation would have been placed before people to demand gold from the Bank of England for its own notes or for Currency Notes, and to sell the withdrawn gold for its current market price. A few withdrawals for this purpose are known to have taken place. There has also been some melting up of gold coins in internal circulation for the sake of profit by the sale of the metal. Any attempt to obtain gold in large quantities from the Bank of England, except when authorized for export, would, of course, have compelled the Government to empower the Bank of England to suspend gold payments against its own notes or Currency Notes. In effect, therefore, if not in name, it must be said that the gold standard in the United Kingdom has been suspended since the early stages of the war.

Silver began to show a gradual and material rise in price from the year 1916. On 10th February, 1914, the cash price of silver per ounce standard was $26\frac{5}{8}$d. Just before the war, on 28th July, 1914, the price was $24\frac{7}{16}$d. On 10th February, 1915, $22\frac{11}{16}$d.; on 10th February, 1916, 27d.; on 9th February, 1917, $37\frac{5}{8}$d.; on 8th February, 1918, 43d.; on 8th February, 1919, $48\frac{7}{16}$d.; and on 11th February, 1920, the record price of $89\frac{1}{2}$d. was reached. The rise was very rapid during the last quarter of 1919 and the first six weeks of 1920. Since 11th February, 1920, there has taken place a great fall in the price of silver, the price on 11th February, 1921, being $36\frac{1}{4}$d. per ounce, and on 6th May, 1921, $34\frac{3}{4}$d. per ounce.

The rapid rise in the price of silver during the closing months of 1919 and the first few weeks of 1920, making the intrinsic value of the silver coinage of the United Kingdom greater than the face value, a Coinage Act (10 Geo. 5, c. 3)[1] was passed on 31st March, 1920, reducing the fineness of the silver in coins thereafter minted from "925 fine" to "500 fine." The effect of this alteration is that new silver coins will be one-half silver and one-half alloy. In

[1] For copy of Act see Appendix VI.

pre-war times the Mint made a substantial profit on the coinage of silver currency.

A commencement of the issue of the new silver coinage was made on Monday, 13th December, 1920, notwithstanding that the previous necessity for the reduction in its fineness had passed away with the subsequent rapid fall in the price of silver. It is interesting to note that the fineness of the silver previously minted had been in force since the reign of Queen Elizabeth.

In the following table there is shown the highest and lowest prices of silver (in pence per ounce standard),[1] and the average price for the year for each year since 1913[2]—

MAXIMUM, MINIMUM, AND AVERAGE PRICE OF SILVER

	1913.	1914.	1915.	1916.	1917.	1918.	1919.	1920.
Highest quotation	$29\frac{3}{8}$	$27\frac{3}{4}$	$27\frac{1}{4}$	$37\frac{1}{8}$	55	$49\frac{1}{2}$	$79\frac{1}{8}$	$89\frac{1}{2}$
Lowest quotation	$25\frac{15}{16}$	$22\frac{1}{8}$	$22\frac{5}{16}$	$26\frac{11}{16}$	$35\frac{11}{16}$	$42\frac{1}{2}$	$47\frac{3}{4}$	$38\frac{7}{8}$
Range of prices .	$3\frac{7}{16}$	$5\frac{5}{8}$	$4\frac{15}{16}$	$10\frac{7}{16}$	19 [illegible]/16	7	$31\frac{3}{8}$	$50\frac{5}{8}$
Average price .	$27\frac{9}{16}$	$25\frac{5}{16}$	$23\frac{11}{16}$	$31\frac{5}{16}$	$40\frac{7}{8}$	$47\frac{9}{16}$	$57\frac{1}{16}$	$61\frac{7}{16}$

During part of 1918 and part of 1919 the price of silver was controlled by the British and American Governments. A Treasury Order issued in this country on 13th August, 1918, fixed the maximum price at $48\frac{13}{16}$d. per ounce standard. Soon after, the United States Government fixed the maximum at $101\frac{1}{2}$ cents per ounce fine. The British Government followed suit on 21st August by raising the maximum in this country to $49\frac{1}{2}$d. On 5th May, 1919, in the United States, and four days later, on 9th May, in the United Kingdom, Government control of price was removed from silver.

The rapid rise in the price of silver from 1916 onwards to February, 1920, was due to a variety of causes. As a commodity it would tend to rise with general prices. Increasing insurance and freight rates would tend to have some influence on the market price of silver. During 1918 and 1919 enormous amounts of silver were necessary to pay for the heavy excess of goods imported from India and China. (Gold exports to India have necessarily had to be

[1] Standard silver was then thirty-seven fortieths fine silver, three-fortieths alloy; or millesimal fineness 925.

[2] Prices furnished by Messrs. Pixley & Abell, bullion brokers, London.

considerably restricted since 1915.) The net imports of silver into India during the twelve months ending 31st March, 1919, amounted to 112 per cent. of the world's production of the metal during the same period, as against 26 per cent. of the annual average production in the pre-war quinquennium, 1910-1914. By the Pittman Act, passed in the United States on 23rd April, 1918, India obtained about 200,000,000 fine ounces of silver from America during 1918 and 1919. The rise in world commodity prices would, in itself, cause an increased demand for silver in Eastern countries. Extensive hoarding of the metal in interior parts of certain countries was also another factor contributing to scarcity. And finally there is the shrinkage in silver production since 1914 to be borne in mind as an important influence tending to cause the market price to rise. The extent of the shrinkage is disclosed by the following table, which shows the annual production of silver since 1901—

WORLD'S PRODUCTION OF SILVER

(In millions of fine ounces)

1901	173·0	1911	226·2
1902	162·8	1912	224·3
1903	167·7	1913	223·9
1904	164·2	1914	168·4
1905	172·3	1915	184·2
1906	165·0	1916	168·8
1907	184·2	1917	174·2
1908	203·1	1918	197·4
1909	212·1	1919	174·5
1910	221·7	1920	169·0[1]

The fall in the price of silver since February, 1920, may, in the main, be attributed to the following causes—the balance of trade moving against India and China, the fall in commodity prices, the demonetising of silver by certain countries, and the reduction of the fineness of new silver coinage issued in the United Kingdom and her Dominions, and in certain foreign countries. The decline in insurance and freight rates would also have some influence.

On 23rd December, 1920, an Act was passed (known as Gold and Silver (Export Control, etc.) Act[2]) to control the exportation of gold and silver coin and bullion, and to prohibit the melting or improper use of gold and silver coin. Restrictions on the export of silver bullion were, however, removed on 8th February, 1921.

[1] Subject to correction.
[2] For copy of Act, see Appendix VII.

For lack of reliable data, it is not possible to compare with any degree of accuracy the amount of gold and silver coin in the hands of the public at the outbreak of the war with the amount at the time of writing. All that can be done is to give some rough figures. According to an estimate by the Mint, the amount of gold coins in the hands of the general public (exclusive of the banks) at 30th June, 1914, was £78,300,000. This estimate of the Mint involved a calculation extending back to 1903, and in which an allowance had to be made for coins used in manufacture, and for invisible exports of coins. From the details of the calculation furnished by the Mint it would appear that these two indeterminable sources of loss of coins had been under-estimated, particularly the amount of gold coin melted up and used in various arts and manufactures. In a table given on the next page, it will be observed that Mr. A. H. Gibson estimates the amount of gold coin in the hands of the general public at 30th June, 1914, at an amount not exceeding £50,000,000. This estimate is partly confirmed by figures given in the Interim Report of the Committee on Currency and Foreign Exchanges after the War, issued on 29th October, 1918. This Committee estimated the amount of gold coin held by banks (excluding gold coin held in the Issue Department of the Bank of England) and in public circulation at £123,000,000. As the amount of gold coin held by the banks at the commencement of the war is generally considered to have been about £70,000,000,[1] the amount in the hands of the general public would be in the neighbourhood of £50,000,000. What the amount in the hands of the general public is at the time of writing, it is impossible to state, but probably about £10,000,000. During the issue of the various War Loans, it was noticed that a few of the applicants elected to pay part or the whole of their subscriptions in gold, which they must obviously have hoarded in their homes. Though gold has disappeared from circulation, it still trickles into the banks in small amounts. Farmers and people residing in small villages, agricultural districts, and in out-of-way places, particularly on hill tops, have always shown a tendency to hoard gold coins. This fact is well known to Savings Banks. Hoarders of this character were little influenced by Treasury notices issued during the war inviting the public to exchange gold coins for Currency Notes at the Post Offices and the

[1] Some authorities estimate the amount at about £65,000,000.

Estimate of the Amounts of Gold and Silver in the Possession of the Public Before the War

By Mr. A. H. Gibson

A. *Liberal estimate of amount of gold and silver in the pockets and homes of the public before the war (exclusive of that in tills and safes of shops, etc.)*—

Amount of Gold per family.	IN MILLIONS: APPROXIMATE.		
	Number of Families.[1]	Total amount of Gold held.	Total amount of Silver held.
		£	£
None	0·50	—	
10 0	1·00	0·50	
£1 0 0	2·00	2·00	
£1 10 0	2·00	3·00	
£2 0 0	1·50	3·00	6·00
£2 10 0	1·00	2·50	
£3 0 0	0·50	1·50	
	8·50	12·50	6·00
£3 10 0	0·25	1·00	
£4 0 0 £4 10 0 £5 0 0	0·50	2·25	1·50
Between £5 and £10	0·50	3·75	
Above £10 . . .	0·25	5·00	
Hoarded . . .	—	5·50	0·50
	10·00	30·00	8·00

B. *Liberal estimate of amount of gold and silver in the tills and safes of shops, mills, warehouses, hotels, public-houses, farm-houses, lodging-houses, hospitals, schools, railway offices, post offices, and various other classes of offices*—

But Exceeding.	Not Exceeding.	IN MILLIONS: APPROXIMATE.		
		Number of Shops, etc.[1]	Total amount of Gold held.	Total amount of Silver held.
			£	£
	£ 2	0·125	0·20	
£ 2	£ 3	0·150	0·40	
£ 3	£ 5	0·200	0·80	
£ 5	£10	0·350	2·60	7·00
£10	£20	0·250	3·50	
£20	£50	0·150	5·00	
£50		0·075	7·50	
		1·300	£20·00	£7·00

[1] Prior to the war the number of families in the United Kingdom slightly exceeded 10,000,000, and the number of shops, mills, etc., was about 1,300,000.

banks. A copy of one such notice issued by the Treasury on 8th, August, 1915, is given below—

" In view of the importance of strengthening the gold reserves of the country for exchange purposes, the Treasury have instructed the Post Office and all public departments charged with the duty of making cash payments to use notes instead of gold coins whenever possible. The public generally are earnestly requested, in the national interest, to co-operate with the Treasury in this policy by (1) paying in gold to the Post Office and to the banks ; (2) asking for payment of cheques in notes rather than in gold ; (3) using notes rather than gold for payment of wages and cash disbursements generally."

The amount of silver in circulation at 30th June, 1914, and at the time of writing is also an unknown quantity. At the former date a fair estimate would be £15,000,000. At the time of writing the amount probably approximates to about £40,000,000. According to a statement furnished by the Chancellor of the Exchequer to the House of Commons on 2nd March, 1920, the following British silver had been coined and issued by the Mint since 4th August, 1914—

	£
3d. pieces to the value of	1,126,060
6d. pieces ,, ,, ...	2,641,325
1s. pieces ,, ,, ...	8,156,668
2s. pieces ,, ,, ...	10,114,605
2s. 6d. pieces ,, ,, ...	16,187,722
	38,226,380

The statement of the Chancellor of the Exchequer giving no indication of the amount of worn silver coin withdrawn during the same period, nor of silver issued to and withdrawn from the Dominions, Colonies, etc., it is not possible to estimate from it the increase in the amount of silver in the hands of the general public of the United Kingdom since 4th August, 1914. Moreover, some of the new silver will have been absorbed in increased bank reserves of silver. This latter amount, however, will be published in the next Mint Report.

Bank Notes.—As will be observed from the table shown on page 41, a very great increase has taken place in the Bank Note

circulation since the commencement of the recent war ; the total increase in the various issues, during six years, being about £130,000,000, and representing an increase of about 288 per cent. on the active circulation during July, 1914. Of the total increase, notes of the Bank of England account for about £89,000,000, notes of the Scottish banks for about £23,000,000, and notes of the Irish banks for about £18,000,000 (taking four week averages). The issues of the few remaining private banks increased by the small amount of about £100,000, but the issues of the Joint Stock Banks decreased by about £19,000, in fact, disappeared altogether. Owing to provincial banks losing right of issue on amalgamation with London banks. Before the war it was generally considered that from 70 to 75 per cent. of the Bank of England note circulation was in the reserves and tills of the other banks. Such a high percentage, however, can hardly rule at the time of writing, for several reasons. The £5 note at the present time is more than ever used for everyday transactions on account of the considerably increased commodity prices, cost of travelling, etc. It is known that some people have partly evaded their due share of the Excess Profits Duty by cashing cheques at banks for Bank of England Notes for the purpose of hoarding or concealment. Of the great increase of about £39,000,000 in the Bank of England Note circulation during the year ending 7th July, 1920, £16,100,000 was due to Bank of England Notes being set aside in the Currency Note Redemption Account.

The great increase in the Scotch and Irish Bank Note issues is due to the fact that before the war the notes of such banks always had a very active circulation. The public in Scotland and Ireland had become thoroughly accustomed to paper issues. The Government recognizing this truth, Section 4 of the Currency and Bank Notes Act of 6th August, 1914, provided as follows—

> Any bank notes issued by a bank of issue in Scotland or Ireland shall be legal tender for a payment of any amount in Scotland or Ireland respectively, and any such bank of issue shall not be under any obligation to pay its notes on demand except at the head office of the bank, and may pay its notes, if thought fit, in Currency Notes issued under this Act : Provided that notes which are legal tender under this section shall not be legal tender for any payment by the head office of the bank by whom they are issued for the purpose of the payment of notes issued by that bank.

The legal tender status accorded to the notes of Scotch and Irish Banks in the above Section was withdrawn as from 1st January,

1920. Under two Acts of Parliament passed in the year 1845, banks in Scotland and Ireland may issue notes in excess of their authorized issues, provided the excess is covered by gold or silver coin in their possession, the silver not to be more than one-fourth the amount of the gold.

BANK NOTES

AVERAGE CIRCULATION FOR FOUR WEEKS ENDING DATES AS STATED

Bank of England.	Private Banks in England.	Joint Stock Banks in England.	Total.
July 8, 1914—£29,109,149	July 4, 1914—£62,578	July 4, 1914—£19,135	£29,190,862
July 7, 1915—£33,946,480	July 3, 1915—£83,912	July 3, 1915—£25,638	£34,056,030
July 5, 1916—£35,708,966	July 1, 1916—£94,767	July 1, 1916—£30,647	£35,834,380
July 11, 1917—£39,358,081	July 7, 1917—£115,043	July 7, 1917—£28,734	£39,501,858
July 10, 1918—£53,615,662	July 6, 1918—£134,775	July 6, 1918—£31,356	£53,781,793
July 9, 1919—£78,891,950	July 5, 1919—£162,296	July 5, 1919—£4,803	£79,059,049
July 7, 1920—£118,051,840	July 3, 1920—£162,594	July 3, 1920—Nil	£118,214,434

	Irish Banks.	Scotch Banks.	Total.
	£	£	£
Ending July 18, 1914 .	8,038,396	7,990,118	16,028,514
,, ,, 17, 1915 .	13,259,802	11,372,279	24,632,081
,, ,, 15, 1916 .	17,365,776	14,520,385	31,886,161
,, ,, 14, 1917 .	20,069,297	17,451,575	37,520,872
,, ,, 13, 1918 .	28,073,833	23,633,480	51,707,313
,, ,, 12, 1919 .	30,314,131	28,245,813	58,559,944
,, ,, 10, 1920 .	26,569,318	30,678,633	57,247,951

INCREASE IN BANK NOTE CIRCULATION DURING SIX YEARS ENDING JULY, 1920

	£	
Bank of England	88,942,691	
Private Banks in England . .	100,016	
Joint Stock Banks in England . .	19,135	(Decrease)
	89,023,572	
Scotch Banks	22,688,515	
Irish Banks	18,530,922	
Total Increase . . .	£130,243,009	

At the time of writing the latest available figures of the Bank Note circulation of the United Kingdom are as follows—

	Average Weekly Circulation.
	£
Bank of England (month ending 6th April, 1921) . .	129,190,425
Private Banks (month ending 6th April, 1921) . .	2,168
Scotch Banks (month ending 19th March, 1921) .	27,724,820
Irish Banks (month ending 19th March, 1921) . .	22,091,877
United Kingdom	£179,009,290

The Bank of England was the only institution in April, 1921, with note issuing powers in England. The last of the joint stock banks in England with note issuing powers, the Northamptonshire Union Bank, Limited, lost such right on amalgamation with the National Provincial and Union Bank of England, Limited, in June, 1920, and the last of the private banks with the same right (Messrs. Fox, Fowler & Company), lost it on amalgamation with Lloyds Bank in February, 1921.

CHAPTER V

THE BANKING POSITION

It is almost redundant to state that the banking position has been of exceptional interest during and since the war. Axioms have been tested and occasionally found wanting; but, on the whole, the experience of war, both in this country and in Germany, has proved that banking has its real apex in productive power and services. Criticism was levelled at the German banking system in the early stages of the war on the ground that German banks were too directly involved in commercial and industrial enterprises. Inevitable collapse of the German system was predicted if the war proved to be of long duration. More mature consideration leads to the conclusion that neither in Germany nor in this country can there be a permanent collapse of the banking system, provided that the State is ever ready to pledge its credit (in other words, the national productive power) in support of the generally accepted custodians and manufacturers of credit—the banks—in the event of a general demand for payment in the form of legal tender.

Economic theory in relation to banking was triumphant during the war. The maxim that every debit has its contra credit somewhere in the books of the banks of the United Kingdom was amply proved during the successive issues of War Loans and the financing of the war.

In the present chapter the various important changes that have taken place in the British Banking Position since the commencement of the war and up to the time of going to press are reviewed at length, in particular the unprecedented rate of expansion of bank credit with its contra effect of increasing bank deposits, and also of increasing the so-called cash reserves of the banks. A brief account is also included of the amalgamation movement since the outbreak of the war.

The review of the Joint Stock Bank position will show that the great expansion of bank credit during the war was mainly on Government account. Instead of the Government making greater use of the weapon of taxation and instituting a system of compulsory loans, after suitable warning, it chose during the war the

greater evil of paying for part of the goods and services it required for the prosecution of the war by an expansion in bank credit. The economic evils inevitably following in the wake of this vicious system of war finance are considered later, in the chapter on Inflation. All that need be repeated here is that when banks, on behalf of the Government, credit customers who have supplied goods and services for the prosecution of the war, they increase the available purchasing power of the community at a time when there is a great scarcity of goods and services available for civilian consumption. The inevitable then happens—a rapid rise in prices, to be followed later by discontent and labour troubles.

(*a*) The Bank of England

It has well been descriptively said by the Editor of a weekly financial journal that any future historian who relies too closely for information on the Bank of England's Weekly Returns issued during the war is likely to flounder up to his neck. It is not possible to analyze to any degree of accuracy the many fluctuations in the various items of the Weekly Returns that have been issued since August, 1914, for the final figures in such Returns have been no safe guide to the nature and magnitude of financial operations that have taken place in the seven days intervening between the issue of successive returns. War finance necessarily causes many cross transfer entries to be made in the books of the Bank of England—the Central Institution—during the course of each week, of which there is often no evidence in the Weekly Returns. Moreover, the method of accounting in the books of the Bank of England for loans of bankers' spare balances, at fixed rates of interest for short periods (instituted during the war), has not been disclosed. There is every reason to believe that in this matter the Bank of England acted on behalf of the Treasury, such short loans having really been made by the Joint Stock Banks to the Government, the Bank of England simply acting as the medium between the lenders and borrower, and so arranging its method of accounting for such transactions as not to increase its own liabilities on its Weekly Returns. During the time this system was in operation there was little correspondence between the fluctuations in the amount of Ways and Means Advances outstanding and the amount of Government Securities in the Weekly Returns. This subject is

referred to again when discussing the influences that gave rise to an increase in the cash reserves of the Joint Stock Banks during the war, but below there is given a record of the various changes that were made in the rates offered for bankers' spare balances.

Rates for Loan of Bankers' Spare Balances.—The system by which the Bank of England took loans from the other banks at fixed rates of interest, repayable at three days' notice, unless specially fixed for longer periods, was introduced at the commencement of 1916, but at first it was restricted to loans from the clearing banks. It necessarily gave the Bank of England a great control over the money market, for the rate it offered on spare balances practically established a minimum below which the main dealers in credit would not lend. It also practically displaced the official minimum discount rate as the governing factor in the money market. During the first half of the year 1916, such interest rate varied from 4 to 4½ per cent. For the greater part of the second half of the year (since the middle of July) the rate was 5 per cent. During the second week in January, 1917, after the cessation of sales of Treasury Bills, it was announced that the Bank of England was prepared to take spare balances from the Scottish and Colonial banks, as well as from the clearing banks, the rate (for spare balances from the Scottish and Colonial banks) being 4½ to 5 per cent., according to the currency of the loan. On 26th February, 1917, the Bank of England again altered the rate it was allowing on loans of spare balances from other banks, making it 4½ per cent. in the case of the clearing banks, and 4 and 4½ per cent. in the case of other banks, according to the currency of the loan. Although the Bank Rate was reduced from 5½ per cent. to 5 per cent. on 5th April, 1917, no change was made by the Bank of England in its special deposit rate of 4½ per cent. for bankers' spare balances. On 19th June, 1917, however, the special deposit rate for bankers' spare balances was again reduced, to 4 per cent. in the case of the clearing banks, and to 3½ per cent. in that of other banks. It will be observed that on each occasion of change in rates, the rate given by the Bank of England to banks outside the clearing was kept ½ per cent. below the rate given to the clearing banks.

On 15th November, 1917, the Bank of England made a commencement of differentiating the rates of interest it was prepared to allow on deposits of home and foreign money. On that date

it announced a special rate of 4½ per cent. on deposits of foreign money made through the clearing banks, but no alteration was made in the rate for domestic deposits by the clearing banks, which rate remained at 4 per cent. A reduction from 4 to 3½ per cent. was made by the Bank of England on 2nd January, 1918, in the rate for loans of domestic money from the clearing banks, but no alteration was made in the rate for foreign money, which remained at 4½ per cent. From this date the sources from which deposits of foreign money would be received were widened and not restricted to the clearing banks. On 14th February, 1918, the rate at which new issues of Treasury Bills were offered was reduced from 4 to 3½ per cent. On the same day the Bank of England reduced from 3½ to 3 per cent. its rate for domestic loans from the clearing banks. The rate on foreign money remained at 4½ per cent. The Bank of England decided on 8th January, 1919, to withdraw, in the case of French, Belgium, and Italian deposits, the special rate of 4½ per cent. allowed for loans of foreign money. As the exchanges of such countries were in favour of London, there was obviously no necessity to continue the high rate of interest for such deposits. On 21st July, 1919, it was announced that the Bank of England would cease on the following Wednesday, 23rd July, to allow 3 per cent. on three-day deposits made by the clearing banks, and that after the end of the month it would allow no interest on existing deposits. No alteration was, however, then made in the 4½ per cent. rate allowed on certain foreign balances, which remained in operation until finally withdrawn on 20th October, 1919.

Position at Yearly Intervals.—Reference has already been made to the impossibility of drawing any definite conclusions from the Weekly Returns issued by the Bank of England since the commencement of the war. Though the position of the Bank of England at yearly intervals since 6th August, 1913, is given on page 50, the figures shown convey no indication of the great fluctuations in the various items during the course of each year. Government borrowing in the form of Ways and Means Advances, and the issue of the various War Loans, have given rise to very great fluctuations in the items constituting the Weekly Returns.

To those who are not conversant with the significance to be attached to fluctuations in the items constituting the Bank of

England Weekly Returns, the following explanatory remarks may be of some assistance in reading the returns in the future. Taking the return relating to the Banking Department, the item "Public Deposits" represents balances standing to the credit of various Government Departments. The item "Government Securities" includes Government obligations for temporary loans made to it, usually known as Ways and Means Advances. The item "Other Deposits" includes the balances standing to the credit of the other banks and to its other customers. And the item "Other Securities" includes securities deposited by its various customers other than the Government for loans made or credited to them. Now, a most important point to note about the Central Institution is that advances made by it do not usually entail withdrawals of legal tender, unless there is a greater demand for legal tender by the public or the other banks withdraw same to strengthen the reserves in their own strong rooms. Occasionally gold is withdrawn from the Bank of England for export. Whoever obtains an advance from the Bank of England, whether it be the Government, an institution, or a member of the money market or of the public, the drafts drawn against the advance will generally be paid into the other banks, because they are the bankers of the general public. The drafts are later paid into the Bank of England by the other banks to their own credit. It may therefore be said that advances by the Bank of England simply involve, in the main, entries in its own books, and the final result is an increase in the balances of the other banks.

Ways and Means Advances, about which there has been much discussion during and since the war, are temporary advances by the Bank of England[1] to the Government. This was a very justifiable form of advance before the war to provide the Government with credit for temporary and short periods whilst awaiting the receipts from taxation. During the war and since, the Government has called upon the Bank of England to make very large advances of this character to supply the deficiency between expenditure and receipts from War Loans and taxation. The amount of such advances outstanding has varied considerably at different times. The evil of such advances is that the amount thereof is eventually

[1] Ways and Means Advances are also made by Public Departments to the Government.

transferred to the balances of the other banks at the Bank of England. On the strength of these increased balances, the other banks are able to make further loans to their own customers, and all the evils of inflation arise. When the Government proceeds to pay off Ways and Means Advances, the opposite effect is produced. The balances of the other banks at the Bank of England tend to fall by a like amount, and the other banks are left with greatly increased liabilities for purchasing power to the public resting on a considerably reduced cash basis.

That the Bank of England does not view with favour the making of Ways and Means Advances to the Government for long periods is obvious from letters that have frequently passed between the Chancellor of the Exchequer and the Bank of England. Below there are given copies of two such letters—

COPY OF LETTER

FROM THE CHANCELLOR OF THE EXCHEQUER TO THE BANK OF ENGLAND, 16TH SEPTEMBER, 1919

I am to request that you will move your Court to consent to advance during the quarter ending the 31st December, 1919, such amounts as may from time to time be required for the Public Service at such rates of interest as may from time to time be agreed.

I would propose that the arrangements set out in the second paragraph of my predecessor's letter of the 5th January, 1918, should again apply to any advances made by the Bank during the quarter in response to this request.

COPY OF LETTER

FROM THE BANK OF ENGLAND TO THE CHANCELLOR OF THE EXCHEQUER, 22ND SEPTEMBER, 1919

We beg to inform you that your letter of the 16th instant was laid before the Court of Directors at their last meeting, and that they agreed to advance during the quarter ending the 31st December such amounts as may from time to time be required for the Public Service at such rates of interest as may from time to time be agreed.

The arrangements set out in the second paragraph of your predecessor's letter of the 5th January, 1918, again to apply to the advances made by the Bank during the ensuing quarter.

The Court, however, desire us to draw your attention both to the amount and to the duration of these Advances, which for the past two years have in effect to a large extent partaken of the nature of a continuous loan; and again to express the earnest hope that such loans may hereafter be obtained from the public, and the Advances from the Bank once more confined to the temporary requirements of the Treasury which it has long been the Bank's privilege and pleasure to furnish.

Comparing the Weekly Return of the Bank of England dated 4th August, 1920, with the one dated 22nd July, 1914 (just before the war), the changes in the various items making up the return were as follows—

(1) The Note Circulation (notes issued by Issue Department less notes in Banking Department) increased by £97,171,785. Part of this increase was due to the Joint Stock Banks transferring early in 1920 the remainder of their gold reserves (estimated at £35,000,000-£40,000,000) to the Bank of England, and substituting in part Bank of England Notes in their own reserves. Some part of the increase may have been due to people subject to the Excess Profits Tax who have cashed cheques and taken part or the whole of the proceeds in the form of notes for hoarding purposes, with the object of part evasion of the tax. Before the war it was generally considered in financial circles that from 70 to 75 per cent. of the Bank of England Note circulation was in the tills, safes, and strong rooms of the Joint Stock Banks. The increase in the Note circulation includes Bank of England Notes for £18,600,000 set aside in the Currency Note Redemption Account, in accordance with a provision made in a Treasury Minute dated 15th December, 1919. This matter is considered in the chapter on Currency.

(2) The amount of gold coin and bullion held by the Bank of England in the Issue Department increased by £82,965,050 (nearly one-half of which was transferred from the Joint Stock Banks). In the Banking Department the amount of gold and silver coin decreased by £21,216.

(3) Public Deposits increased by £3,727,061, and Other Deposits by £88,500,501, making a total increase in deposits of £92,227,562. The greater part of the increase in "Other Deposits" was due to increase in the balances of the Joint Stock Banks at the Bank of England.

(4) Government Securities increased by £65,260,814, and Other Securities by £41,155,803, making a total increase in securities of £106,416,617.

(5) The Banking Reserve (notes, gold, and silver coin in Banking Department) decreased by £14,227,951 (£12,408,474 of this decrease took place since 30th July, 1919), but if expressed as a proportion of the total deposit liabilities it fell from 52 per cent. to 10 per cent.

(6) Seven day and other bills increased by £1,685.

THE POSITION OF THE BANK OF ENGLAND AT YEARLY INTERVALS SINCE 6TH AUGUST, 1913

BANK OF ENGLAND

ISSUE DEPARTMENT

At	Notes Issued.	Total.	Government Debt.	Other Securities.	Gold Coin and Bullion.	Total.
	£	£	£	£	£	£
Aug. 6, 1913 .	55,970,030	55,970,030	11,015,100	7,434,900	37,520,030	55,970,030
July 22, 1914 .	57,014,410	57,014,410	11,015,100	7,434,900	38,564,410	57,014,410
July 29, 1914 .	55,121,405	55,121,405	11,015,100	7,434,900	36,671,405	55,121,405
Aug. 5, 1914 .	44,491,070	44,491,070	11,015,100	7,434,900	26,041,070	44,491,070
Aug. 4, 1915 .	79,657,775	79,657,775	11,015,100	7,434,900	61,207,775	79,657,775
Aug. 2, 1916 .	71,360,195	71,360,195	11,015,100	7,434,900	52,910,195	71,360,195
Aug. 1, 1917 .	68,295,650	68,295,650	11,015,100	7,434,900	49,845,650	68,295,650
July 31, 1918 .	85,012,730	85,012,730	11,015,100	7,434,900	66,562,730	85,012,730
July 30, 1919 .	104,681,285	104,681,285	11,015,100	7,434,900	86,231,285	104,681,285
Aug. 4, 1920 .	139,979,460	139,979,460	11,015,100	7,434,900	121,529,460	139,979,460
Increase since July 22, 1914 .	82,965,050	82,965,050	—	—	82,965,050	82,965,050

BANKING DEPARTMENT

Liabilities.

At	Proprietors' Capital.	Rest.	Public [1]Deposits.	Other Deposits.	7-Day and Other Bills.	Total.
	£	£	£	£	£	£
Aug. 6, 1913 .	14,553,000	3,512,457	9,350,113	39,822,865	13,734	67,252,169
July 22, 1914 .	14,553,000	3,446,453	13,735,393	42,185,297	14,796	73,934,939
July 29, 1914 .	14,553,000	3,491,756	12,713,217	54,418,908	10,969	85,187,850
Aug. 5, 1914 .	14,553,000	3,547,083	11,499,452	56,749,610	10,312	86,359,457
Aug. 4, 1915 .	14,553,000	3,450,561	147,058,621	84,221,335	41,081	249,324,598
Aug. 2, 1916 .	14,553,000	3,410,042	51,009,979	85,517,391	31,924	154,522,336
Aug. 1, 1917 .	14,553,000	3,399,004	44,811,739	128,744,196	16,167	191,524,106
July 31, 1918 .	14,553,000	3,434,289	37,789,088	138,440,986	10,083	194,227,446
July 30, 1919 .	14,553,000	3,364,409	17,881,009	116,554,700	13,812	152,366,930
Aug. 4, 1920 .	14,553,000	3,405,872	17,462,454	130,685,798	16,481	166,123,605
Increase since July 22, 1914 .	—	-40,581	3,727,061	88,500,501	1,685	92,188,666

[1] Including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts.

Assets.

At	Government Securities.	Other Securities.	Notes.	Gold and Silver Coin.	Total.
	£	£	£	£	£
Aug. 6, 1913 . .	12,756,539	26,988,361	26,013,865	1,493,404	67,252,169
July 22, 1914 . .	11,005,126	33,632,762	27,697,120	1,599,931	73,934,939
July 29, 1914 . .	11,005,126	47,307,530	25,415,055	1,460,139	85,187,850
Aug. 5, 1914 . .	11,041,152	65,351,656	8,385,650	1,580,999	86,359,457
Aug. 4, 1915 .	46,874,146	155,264,727	46,171,745	1,013,980	249,324,598
Aug. 2, 1916 . .	42,188,361	75,657,166	34,702,570	1,974,239	154,522,336
Aug. 1, 1917 . .	50,439,661	110,654,852	27,819,240	2,610,353	191,524,106
July 31, 1918 . .	58,601,132	106,787,164	28,142,390	696,760	194,227,446
July 30, 1919 . .	43,143,806	81,745,550	25,294,030	2,183,544	152,366,930
Aug. 4, 1920 . .	76,265,940	74,788,565	13,490,385	1,578,715	166,123,605
Increase since July 22, 1914 . .	65,260,814	41,155,803	- 14,206,735	- 21,216	92,188,666

The increase, namely, £106,416,617, in the item Securities shows the extent to which the Bank of England, partly on account of the Government, manufactured additional credit during the course of the war, and up to 4th August, 1920, and gives a reason for part of the great increase that took place in the so-called cash reserves of the Joint Stock Banks (cash in hand and at Bank of England) during the course of the war. For, as already stated, credit manufactured by the Bank of England, in the main, usually gravitates by transfer to the balances of the Joint Stock Banks at the Bank of England, if not in the first instance loaned direct to one or more of the Joint Stock Banks. This matter is further explained later, when reviewing the causes of the great increase in the cash reserves of the Joint Stock Banks during the war.

The sum of £160,428,000 was repaid to the Bank of England during the year ending 31st March, 1916, for advances previously made for war purposes by that Institution.

Below there is given the Bank of England Weekly Return dated 25th May, 1921—

BANK OF ENGLAND

WEEK ENDED WEDNESDAY, 25TH MAY, 1921

ISSUE DEPARTMENT

	£		£
Notes issued . . .	144,990,915	Government debt . .	11,015,100
		Other securities. . .	7,434,900
		Gold coin and bullion .	126,540,915
	£144,990,915		£144,990,915

BANKING DEPARTMENT

Liabilities.	£	*Assets.*	£
Proprietors' capital .	14,553,000	Government securities .	38,106,122
Rest	3,193,391	Other securities. . .	89,139,884
Public deposits[1] . .	16,419,417	Notes	17,183,255
Other deposits. . .	112,060,283	Gold and silver coin .	1,808,632
Seven-day and other bills	11,802		
	£146,237,893		£146,237,893

Comparing the above return with that dated 4th August, 1920, the figures of which have been already given, the following changes are shown in the various items—

[1] Including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts.

(1) Notes in Circulation, increase £1,318,585.

(2) Gold coin and bullion (Issue Department), increase £5,011,455. Gold and silver coin (Banking Department), increase £229,917.

(3) Public Deposits, decrease £1,043,037; other Deposits, decrease £18,625,515; total deposits, decrease £19,668,552.

(4) Government Securities, decrease £38,159,818; other Securities, increase £14,351,319; total securities, net decrease £23,808,499.

(5) The Banking Reserve, increase £3,922,787, the Reserve representing 15 per cent. of total deposit liabilities, as against 10 per cent. on 4th August, 1920.

The above changes indicate material improvement in the position of the Bank of England between the two dates.

ARRANGEMENT MADE WITH THE FEDERAL RESERVE BANK OF NEW YORK.—On 3rd May, 1917, the following interesting announcement was made concerning the establishment of important relations between the Bank of England and the Federal Reserve Bank of New York, which relations should prove of considerable practical value in the future—

"Negotiations for establishing relations between the Bank of England and the Federal Reserve Bank of New York, which were commenced by the Governors of the respective institutions some months ago, have now been concluded. The arrangement provides that the Bank of England will act as the correspondent and agent in London of the Federal Reserve Bank of New York, and that the Federal Reserve Bank of New York will act in a similar capacity in New York for the Bank of England. It is not the intent of the plan that these institutions engage in commercial foreign transactions, the relationship established being primarily for the purpose of affording greater stability to rates of exchange by maintaining with each other mutual accounts of deposit, and by representing each other in the purchase of bills. The plan will also create machinery by which transactions in gold and gold coin will be facilitated, which should result, in normal times, in eliminating or reducing the extensive and unnecessary shipments of gold between nations to settle international balances, which have heretofore not infrequently prevailed. The relationship will also establish a means by which it is hoped financing between the two countries can be accomplished in times of emergency without undue strain upon the exchanges. Provision is made for

participation by other Federal Reserve Banks of the United States desiring to join in the transactions contemplated."

Bank Rate Changes.—A record of Bank Rate changes since the commencement of the year 1914, and up to 31st July, 1921, is shown in the table appended—

BANK RATE CHANGES

Date of Change.			Rate.	Duration in Days.
			%	
1914	January 8	Thursday	4½	14
"	" 22	"	4	7
"	" 29	"	3	182
"	July 30	"	4	1
"	" 31	Friday	8	1
"	August 1	Saturday	10	5
"	" 6	Thursday	6	2
"	" 8	Saturday	5	705
1916	July 13	Thursday	6	189
1917	January 18	"	5½	77
"	April 5	"	5	945
1919	November 6	"	6	161
1920	April 15	"	7	378
1921	April 28	"	6½	56
"	June 23	"	6	28
"	July 21	"	5½	—

In normal times Bank Rate changes are largely governed by the course of the foreign exchanges. During the war the changes were governed by domestic conditions, but the rates were at times merely nominal. Generally speaking, discount rates since 1915 have been largely governed by the rates advertised for daily sales of Treasury Bills. It is also to be noted, as already stated, that during the period the Bank of England offered to borrow bankers' spare balances at fixed rates of interest, such rates displaced the official discount rate as the governing factor in the money market For some years previous to the war, the Bank Rate had shown an upward tendency, if averages be considered. During the forty years 1871–1910, the rate averaged £3 6s. 8d.; during the thirty years 1881–1910, it averaged £3 6s. 9d.; during the twenty years 1891–1910, £3 5s. 3d.; during the ten years 1901–1910, £3 12s. 3d.; and during the five years 1906–1910, £3 16s. 2d. For the year 1911, the rate averaged £3 9s. 5d.; for 1912, £3 15s. 6d.; and for 1913, £4 15s. 5d. It would almost appear that the upward tendency in recent pre-war years indicated the coming European conflagration.

As already stated, Bank Rate during the war was mainly governed by domestic conditions, and not by the usual ebb and flow of gold

between London and foreign centres. Below are given brief reasons for the changes that have been made in the rate since July, 1914.

On Thursday, 23rd July, 1914, Austria-Hungary sent its ultimatum to Serbia. On Saturday, 25th July, conditions approaching panic began to manifest themselves on the London Stock Exchange and the Continental Bourses. The following week the foreign exchanges fluctuated in an unprecedented manner, and finally broke down altogether. On Tuesday, 28th July, Austria-Hungary declared war against Serbia. By Thursday, 30th July, all the Stock Exchanges had closed with the exception of London, New York, and the official market at Paris. After the close of business on this day, the London Stock Exchange decided not to re-open. The New York Stock Exchange also decided to close when it heard of the closing of the London Stock Exchange, being unable to absorb the stream of its own securities thrown on it by the Continent and the United Kingdom. On Saturday, 1st August, Germany declared war against Russia. On Sunday, 2nd August, a state of war existed between Germany and France, and on the following day Germany declared war on France. War was declared between Great Britain and Germany on Tuesday, 4th August. Whilst these great events were happening, there took place a great rush of bill holders to the Bank of England with bills to discount. On Thursday, 30th July, the Bank raised its official minimum from 3 to 4 per cent. The closing of the London Stock Exchange the next day intensified this rush to such an extent that the Bank had immediately to raise its rate to 8 per cent. Even this drastic increase did not stem the flood of bills that poured into the Bank from all quarters for discount. Next day, on 1st August, the official rate was further raised to 10 per cent.; and Government intervention became imperative. On Sunday, 2nd August, a Moratorium was proclaimed in England on bills of exchange. On Monday, 3rd August, Bank Holiday was extended to Thursday, 6th August, inclusive. On the Thursday a general Moratorium was proclaimed in the United Kingdom to remain in force until 4th September, and the Currency and Bank Notes Act was passed, authorizing the Treasury to issue Currency Notes for £1 and 10s. as legal tender for any amount. These protective measures enabled the Bank of England to reduce its official minimum to 6 per cent. on Thursday, 6th August, and to make a further reduction to 5 per

cent. on Saturday, 8th August. From 23rd July to 29th July inclusive, the Bank of England's holding of "Other Securities' increased by about £13,700,000, and from 30th July to 1st August, inclusive, by about £18,000,000, the greater part of which increase is considered to have represented accommodation to the bill brokers in an attempt to meet the calls made on them from the other banks.

The next change in the Bank Rate took place on Thursday, 13th July, 1916. On that day the rate was raised from 5 to 6 per cent., in order to protect the London Money Market against the possible effects of a sudden upward movement that had taken place in money rates in New York, which later experience proved to be only temporary. On Thursday, 18th January, 1917, the official minimum rate was reduced from 6 to 5½ per cent., the decline being attributed to improved money market conditions in New York, largely due to the early return flow of money from the Western States to New York and continued large arrivals of gold from Europe. Completion of arrangements for a further British Loan in America for $250,000,000 (roughly, £50,000,000) also helped the reduction. A further reduction in Bank Rate, from 5½ to 5 per cent., took place on Thursday, 5th April, 1917, the day America entered the war on the side of the Allies. After this date no further change in Bank Rate was made until Thursday, 6th November, 1919, an interval of 945 days. This is the longest period since the Bank Act was passed in 1844 that Bank Rate has remained at one rate without change. From 22nd February, 1894, to 10th September, 1896, it remained at 2 per cent., a period of 931 days; and, as already stated, from 8th August, 1914, to 13th July, 1916, it remained at 5 per cent., a period of 705 days. The change made on Thursday, 6th November, 1919, was an increase in the rate from 5 to 6 per cent. This change was due to a combination of causes, but in the main it was designed to check the speculative movement that became pronounced during the closing months of 1919, and to administer an effective check to the demand for further expansion of bank credit, if not to commence a gradual process of deflation. The rise in Bank Rate was followed the next day by an increase in the rate for Treasury Bills to 5½ per cent. A further increase in Bank Rate from 6 to 7 per cent. was made on Thursday, 15th April, 1920. As in the case of the previous increase, the change was due to several causes. Speculation was still active,

and there were continuous demands for further loans from the banks. On the preceding day, the rate for Treasury Bills had been raised to 6½ per cent., owing to non-renewal by bankers and others during the previous fortnight of large amounts of maturities. As a consequence, the Government had been compelled to meet such bills largely by Ways and Means advances obtained from the Bank of England. A further cause of the increase to 7 per cent. in Bank Rate may be traced in the restriction of the fiduciary issue of Currency Notes, reference to which is made in the chapter on Currency.

Speculation having practically ceased, and a heavy fall in commodity prices having been in progress since May, 1920, a first-step reduction in Bank Rate from 7 to 6½ per cent. was made on Thursday 28th April, 1921. It was preceded by a reduction in the Treasury Bill rate, for three months' maturities, from 6½ to 6 per cent., on 11th March, and the institution again, on 21st April, of the "tender" and "additional sale" system of issue of Treasury Bills (*see* chapter VI, section "Treasury Bills"). The rate for twelve month Treasury Bills was reduced from 6 to 5¾ per cent. on 26th April. It is interesting to note that only on two previous occasions since the Bank Act was passed in 1844 has Bank Rate been at 6½ per cent. It was reduced from 7 to 6½ on 4th December, 1856, and from 6½ to 6 a fortnight later, and raised to 6½ on 2nd April, 1857.

A further reduction in Bank Rate, from 6½ to 6 per cent., took place on Thursday, 23rd June, 1921, and a third reduction, from 6 to 5½ per cent., a month later, on Thursday, 21st July, 1921, in both cases partly with the object of lessening the interest burden on industry.

(*b*) Joint Stock Banks

In the following review of the changes that took place in the position of the Joint Stock Banks during the seven years 31st December 1913–31st December, 1920, it is to be understood that the general expression "Joint Stock Banks" includes not only banks which are established under the Joint Stock Companies Acts, but also the few private banks remaining in the United Kingdom. It has also to be borne in mind that the banks are considered together as one unit. The Armistice with Germany was signed on 11th November, 1918, and Peace declared on 28th June, 1919.

On this and following pages tables are given comparing the balance sheet position of the Joint Stock Banks at the end of 1919 with that at the end of 1913, an interval of six years. (The relative position at the end of 1920 is considered later.) The main changes that took place in the balance sheet position of the Joint Stock Banks during this period were, it will be observed from tables (*a*) and (*c*), an increase of £1,328,000,000 in credit balance liabilities to customers, an increase of £271,000,000 in their so-called Cash Reserves (usually described on balance sheets as cash in hand, at Bank of England, etc.), an increase of £389,000,000 in Investments, an increase of £208,000,000 in Bills Discounted, and an increase of £501,000,000 in Advances. All these increases prove, as will be shown later, that there has been considerable credit inflation since the commencement of the recent war, and that the banking position at the end of 1913 was considerably better than that ruling at the end of 1919.

COMBINED BALANCE SHEET OF THE BANKS OF THE UNITED KINGDOM (EXCLUSIVE OF THE BANK OF ENGLAND), 1919 AND 1913[1]

(*Compiled by "The Statist," and published in its issues dated* 15*th May,* 1920, *and* 25*th July,* 1914)

TABLE A. LIABILITIES

	1919		1913		
		% of Total.		% of Total.	Increase for Six Years.
	£		£		£
Capital paid up.	77,155,000	2·8	71,202,000	5·6	+ 5,953,000
Reserve funds .	64,398,000	2·3	46,621,000	3·7	+ 17,777,000
Total . .	141,553,000	5·1	117,823,000	9·3	+ 23,730,000
Notes in circulation . .	57,413,000	2·1	15,981,000	1·2	+ 41,432,000
Acceptances .	161,095,000	5·8	63,458,000	5·0	+ 97,637,000
Deposit, Current, and other accounts .	2,398,831,000	86·7	1,070,681,000	84·0	+ 1328,150,000
Profit balance .	8,159,000	·3	6,094,000	·5	+ 2,065,000
Total Liabilities	2,767,051,000	100·0	1,274,037,000	100·0	+ 1493,014,000

[1] For its compilations, *The Statist* takes the figures of the last Balance Sheets issued by the various banks. The majority of these, and which are those of the most important banks, are dated 31st December, for the year in question; but a few are dated earlier, between 30th June and 31st December; or later, between 1st January and 1st April. For the purposes of aggregation, the Balance Sheets are taken as if all made up on 31st December.

TABLE B.

ASSETS

	1919		1913		
		% of Total.		% of Total.	Increase for Six Years.
	£		£		£
Cash in hand, at Bank of England, etc.	443,538,000	16·0	173,185,000	13·6	+ 270,353,000
Money at Call and at Short Notice[1]	150,594,000	5·5	124,755,000	9·7	+ 25,839,000
Investments	600,035,000	21·7	210,934,000	16·6	+ 389,101,000
Bills discounted[1]	364,722,000[2]	13·2	121,908,000	9·5	+ 242,814,000
Advances	1,018,476,000[2]	36·8	552,268,000	43·4	+ 466,208,000
Liability of Customers for Acceptances	161,095,000	5·8	63,458,000	5·0	+ 97,637,000
Bank premises, etc.	28,591,000	1·0	27,529,000	2·2	+ 1,062,000
Total Assets	2,767,051,000	100·0	1,274,037,000	100·0	+ 1,493,014,000

In the following pages the annual changes in the various items composing the balance sheets of Joint Stock Banks are reviewed at length since 1913, reasons being given where possible for annual variations. It is not possible to give exact figures in all cases, on account of lack of uniformity among the banks in compiling their balance sheets. It is to be hoped that in the near future the banks will agree to issue a uniform balance sheet. This should now be possible in view of the amalgamation movement having considerably reduced the number of banks in recent years.

In the table of Assets on page 59 it has been assumed that the experience of banks that separate on their balance sheets "Cash in hand and at Bank of England" from "Money at Call and at Short Notice," and "Bills Discounted" from "Advances," the one from the other, is that of all the banks, and the amounts have been apportioned on this basis—

[1] Where stated separately. In all cases banks do not separate on their balance sheets their cash from their call loans or their bills discounted from their advances.

[2] These amounts should really be £346,658,000 and £1,036,540,000, *The Statist* in its summarization of balance sheets having inadverently placed an amount of £18,064,000 in the wrong column.

Combined Balance Sheet of the Banks of the United Kingdom (Exclusive of the Bank of England), 1919 and 1913

Table C. (For Liabilities see Table A on page 57)

ASSETS

	1919	% of Total.	1913	% of Total.	Increase for Six Years.
	£		£		£
Cash in hand, at Bank of England, etc.	423,000,000	15·3	152,000,000	11·9	+ 271,000,000
Money at Call and at Short Notice	171,000,000	6·2	146,000,000	11·4	+ 25,000,000
Investments	600,000,000	21·7	211,000,000	16·6	+ 389,000,000
Bills discounted	376,000,000	13·6	168,000,000	13·2	+ 208,000,000
Advances	1,007,000,000	36·4	506,000,000	39·7	+ 501,000,000
Liability of Customers for Acceptances	161,000,000	5·8	63,000,000	5·0	+ 98,000,000
Bank premises, etc.	29,000,000	1·0	28,000,000	2·2	+ 1,000,000
Total Assets.	2,767,000,000	100·0	1,274,000,000	100·0	+ 1,493,000000

Paid-up Capital and Reserve Funds

The following table shows at annual intervals the amount of Paid-up Capital and Reserve Funds since 1913—

At 31st December.	Paid-up Capital.	Reserve Funds.	Total.
	£	£	£
1913	71,202,000	46,621,000	117,823,000
1914	70,632,000	46,209,000	116,841,000
1915	70,623,000	44,644,000	115,267,000
1916	70,697,000	43,578,000	114,275,000
1917	72·002,000	46,764,000	118,766,000
1918	73,896,000	56,405,000	130,301,000
1919	77,155,000	64,398,000	141,553,000
Increase for six years	5,953,000	17,777,000	23,730,000

The combined balance sheet already given shows that paid-up capital represented only 2·8 per cent. of the total liabilities in 1919 as against 5·6 per cent. in 1913. The corresponding percentages for the Reserve Funds were 2·3 and 3·7, respectively. In the case of both paid-up capital and reserve funds, it is evident

there should be a substantial increase in the near future to support the enormous increase in the credit balance liabilities of the banks since 1913. Part of the increase in capital since 1917 represents duplication through bank purchase of shares in other banks.

Notes in Circulation

The following table shows the annual increases in the amount of notes in circulation (exclusive of Bank of England and Treasury Notes) since 1913—

Notes in Circulation

At 31st December.	Amount.	Increase.
	£	£
1914 . . .	20,708,000	4,727,000
1915 . . .	27,773,000	7,065,000
1916 . . .	34,814,000	7,041,000
1917 . . .	42,293,000	7,479,000
1918 . . .	56,324,000	14,031,000
1919 . . .	57,413,000	1,089,000
Increase for six years .		41,432,000

The increase is practically wholly due to increase in the note circulations of Irish and Scotch Banks. The average weekly circulation for the month ending 3rd January, 1914, of the English Private Banks and English Joint Stock Banks was only about £119,000, and for the month ending 3rd January, 1920, only about £184,000.

Acceptances

The following table shows the annual variations in the amount of acceptances outstanding since 1913—

Acceptances Outstanding

At 31st December.	Amount.	Increase.
	£	£
1914 . . .	50,770,000	– 12,688,000
1915 . . .	65,831,000	15,061,000
1916 . . .	74,336,000	8,505,000
1917 . . .	70,630,000	– 3,706,000
1918 . . .	65,080,000	– 5,550,000
1919 . . .	161,095,000	96,015,000
Increase for six years .		97,637,000

The great increase of £96,015,000 during 1919 in the amount of acceptances outstanding was due to the resumption of overseas trade after the termination of the war. The figure naturally reflects increased prices of commodities. The Joint Stock Banks even before the war were showing an increasing willingness to undertake acceptance business, and doubtless this class of profitable business will continue to grow in the future.

Deposit and Current Account Liabilities to Customers

The following table shows the annual increases in the amount due on Current and Deposit Accounts since 1913—

Amount Due on Current and Deposit Accounts

At 31st December.	Amount.	Increase.
	£	£
1914 . . .	1,167,255,000	96,574,000
1915 . . .	1,271,706,000	104,451,000
1916 . . .	1,478,840,000	207,134,000
1917 . . .	1,742,902,000	264,062,000
1918 . . .	2,033,518,000	290,616,000
1919 . . .	2,398,831,000	365,313,000
Increase for six years .		£1,328,150,000

The enormous increase in banking deposits during the war is a phenomenon which is apparently anomalous. To the casual observer it might appear that the general uncertainty of a state of war, the issue of War Loans, the pressure of taxation and the expenditure of the Government in foreign countries would tend to deplete deposits in banks. On the contrary, the above table shows that deposits increased considerably during the war, the increase for the six years ending 31st December, 1919, being £1,328,150,000, or at the rate of about £221,000,000 per annum. This rate of increase is about seven times the average rate, namely, £30,000,000, experienced during the ten years immediately preceding the war, 1904–1913. As is explained in the following pages, the great increase in bank deposits during the war was primarily due to expansion of bank credit, mainly on Government account.

From the composition of the combined balance sheet of the banks of the United Kingdom (exclusive of the Bank of England) shown already, and the necessity of balancing both sides of the account, it is obvious that at any time the aggregate of customers' credit balances, apart from any excess deposit over withdrawal of legal tender by customers, or a reduction in the relatively small amount of own notes outstanding, can only increase by various forms of credit advances by the banks, or purchases of securities by the banks from the open market, or subscription by the banks to new issues. Even when banks purchase securities from the open market, or subscribe to new issues, it is but a form of bank expansion of credit, for the net effect of an increase in the amount of investments held by a bank is to place an equivalent amount of credit at the disposal of the sellers or issuers of the so-called investments. In their effect in increasing deposits, it is immaterial whether advances be at call, or at short notice, or for more or less fixed periods, or permanent in the form of purchases of securities, and whether made to the Government or the general public. As already stated, prior to the war, during the ten years 1904–1913, bank deposits increased on an average about £30,000,000 a year. Of this increase, about £27,000,000 was due to bank credit expansion; in other words, to bank advances and bank purchase of securities (permanent advances until sale of investments); the remaining £3,000,000 or less being due to excess deposit over withdrawal of legal tender, mainly gold by customers, and possibly increased holdings of Bank of England notes.

The influences that may give rise to an increase in the aggregate of bank deposits, not only in war time but also in peace time, are so little understood by the general public that it will be advisable to consider them individually. Several are secondary in origin. Some of them operate in varied forms according to the presence or absence of various accompanying conditions. Some of these conditions are sufficiently general to reappear in a number of cases. The influences tending to increase credit balances will not necessarily disclose themselves if part or the whole of the created credit is absorbed in liquidation of debit balances, or if other influences are operating at the same time tending to reduce the aggregate of credit balances.

But before discussing in detail the reasons for variation in the

aggregate of bank deposits at any time, it will be advisable to define the meaning attached to the word "Deposits" by Joint Stock Banks. The word is used to cover liabilities by the banks to their customers on current accounts and deposit accounts, as well as sundry inside impersonal accounts in making up their balance sheets, for British banks do not separate such items on their published balance sheets. A more suitable expression than the word "Deposits" to represent bank liabilities to customers and the credit balances of bank impersonal accounts, and one occasionally used in the following pages, is "Credit Balances," or "Total or Aggregate Credit Balances," because bank liabilities to customers, whether on deposit or on current account, represent credit balances at the command of customers.

It is also necessary to bear in mind when analyzing the causes of variation in the aggregate of bank deposits, the difference between the London and the provincial methods of recording loans of credit. The provincial method is to allow a customer to overdraw his account up to the agreed limit, and the account is debited, from time to time, only with the amount of credit actually used and transferred to other persons. In London, however, it is usual for the customer to arrange for a loan of a given amount to be credited to his account forthwith, or to arrange a loan limit and instruct the bank, from time to time, to place specified amounts to his credit under the limit. Under the provincial bank method of recording loans of credit, and considering the banks as a whole, if a bank agrees to grant credit, say to the extent of £10,000 to A, who eventually transfers it to other customers of the same or other banks, the effect on total credit balances and loans will vary according to the relation to the bank of the recipients of A's cheques. If, for instance, A gives a cheque for £10,000 to Z, who already has £3,000 standing to his credit, the total credit balances and loans of the banks, so far as this transaction is concerned, will each be increased by £10,000. If the cheque for £10,000 be paid to Y, who owes his bank, say, £15,000, then the net effect will be no change in the total credit balances or in loans. Again, if A divided his loan equally between Y and Z, the total credit balances and loans will each be increased by £5,000. Further, suppose A pays his loan in equal portions to V and W, each of whom is indebted to his bank for amounts of at least £5,000, then there will be no addition to the

total credit balances nor to loans. This reaction of the destination of bank credits is a phenomenon which occurs frequently in the discussion of causes which follows, and its operation must be allowed for in any attempt at an estimation of their total and composite effects.

Having defined the meaning to be attached to the word "deposits," and explained the difference between the London and provincial methods of recording loans of credit, we will now review at length the influences that may at any time give rise to variation in the amount of deposits, the banks being considered collectively as one unit.

1. INCREASE IN THE CASH HELD BY BANKS OR IN THEIR BALANCES AT THE BANK OF ENGLAND.—It is obvious that if a customer pays in legal tender to his credit at a bank, the effect of the transaction must be to tend to increase the aggregate of credit balances, unless the payment inwards is partly or wholly absorbed in liquidation of a debit balance, or the legal tender has been withdrawn from another bank. Generally speaking, any contraction in the legal tender circulation will tend to reflect itself in an increase in the cash reserves of the banks, and *per contra* in the deposit liabilities. Over a period of years any increase in deposit liabilities due to excess deposit over withdrawal of legal tender must, however, necessarily be small as compared with increase due to credit expansion; for during the fifty-six years 1858-1913, according to Board of Trade Returns, the United Kingdom only imported an excess over exports of gold of about £4,000,000 a year. Part of such excess will have been absorbed by increased currency requirements, jewellery, and the arts and manufactures.

If a bank increases its own cash reserves by withdrawal of legal tender from the Bank of England, its balance thereat will be debited, and obviously there will be no change in the aggregate of credit balances, because balances of customers of Joint Stock Banks would not be affected by such a transfer. If, however, the balance of a Joint Stock Bank at the Bank of England be increased by payment inwards of drafts drawn on the latter bank, and received by the Joint Stock Bank from its own customers, the aggregate of credit balances will tend to be increased unless such customers have debit balances. Other methods by which Joint Stock Bank cash reserves may be increased are discussed later in the chapter.

2. Increase in Money at Call and at Short Notice Loaned by Banks.—An increase in bank loans at call or at short notice will tend to increase the aggregate of credit balances provided the extra credit is transferred by the borrowers to customers of the Joint Stock Banks and is not used in liquidation of debit balances, nor transferred to the Bank of England in liquidation of other loans. Such loans by the Joint Stock Banks are usually made to bill-brokers, the Stock Exchange, and various other financiers. At certain periods of the war, the Government borrowed large amounts of credit from the Joint Stock Banks repayable at short notice, through the medium of the Bank of England. The evil effects of such borrowing, as tending to inflation, are considered hereafter.

3. Changes in the Amount of Floating Foreign Balances in London.—Where these changes are due to exports or imports of gold, the aggregate of credit balances in the United Kingdom will generally tend to decrease or increase—exports of gold tending towards a decrease and conversely. If, on the other hand, the change were due to exports of goods, the accounts of the exporters of the goods would be credited with the proceeds of the goods, while the foreign balances would be debited, and the net effect on credit balances will tend to be either a reduction in the aggregate or else no change in it—the former arising when the credit for exports passes to an account with a previous debit balance. Conversely, a change in the floating foreign balances in London due to imports will result either in an increase or else in no alteration in the aggregate of credit balances.

4. The Calling in of Floating Foreign Balances from Abroad.—The effect on credit balances will vary according to whether the foreign balances are at the call of banks or other institutions and individuals, and also according to the form in which remittance takes place.

(a) *When Called in by Banks.* If the remittance be in gold, it will have no effect on credit balances. The item " Money at Call and at Short Notice " in the bank's balance sheet will be diminished, while " Cash in hand and at the Bank of England " will be increased by the amount remitted. On the other hand, if the remittance is made indirectly in the form of goods, credit balances would tend to diminish as the community pays for the goods ; while advances

would increase if the goods were partly consumed by the community o.. a further extension of credit.

(b) *When Called in by other Institutions or by Individuals.* If the remittance be in gold, and is paid into the banks, credit balances will increase, unless and to the extent such payment be made to accounts where there be debtor balances, in liquidation thereof. Indirect remittance in the form of goods which are sold to the community will tend to create credits and debits in the books of banks of the United Kingdom, which in the aggregate will cancel each other. To the extent, however, that purchasers of the goods pay for them by means of loans from their banks, both credit balances and advances will tend to increase.

5. Decrease in the Amount of Outstanding London Acceptances.—A decrease in the amount of bills drawn from abroad and discounted by banks or other institutions in the United Kingdom will have an effect on credit balances generally similar to that already indicated above in the calling in of floating balances from abroad. When, however, the bills accepted by London banks and financial houses are held abroad, a reduction in the amount of them will have diverse effects upon credit balances in the United Kingdom according to the character of the transactions. (*a*) When bills are accepted for goods supplied to the United Kingdom, gold may be exported from the United Kingdom in payment of some of the indebtedness at maturity. In that case, aggregate credit balances in the United Kingdom will tend to diminish *pro tanto*. (*b*) If, however, goods are exported in order to make final payment, credit and debit entries will be made in the books of the banks of the United Kingdom which will generally tend to cancel each other. (*c*) Where the London acceptances arose in the process of financing trade between foreign countries and were held or discounted abroad, a reduction in the amount of these will have no ultimate effect on the aggregate credit balances in this country, except where default occurs at the maturity of the bills. The circumstances in the latter case involve the same general considerations as occur in the issue of loans by the United Kingdom to Colonies and foreign countries, and may be more conveniently considered under these heads. (See paragraphs 10 and 11).

6. Contraction of Outstanding Trade Debts Within the United Kingdom.—It is probable that the contraction of internal

trade debts at the beginning of the war did not exercise a material effect upon the aggregate of bank credit balances. According to the method of accountancy amongst provincial banks, if both debtor and creditor had credit balances there would be no change in the aggregate of credit balances. Likewise, if both had debit balances, there would be no change. If, on the other hand, the debtor had a credit balance and the creditor a debit balance, the consequence of the reduction or payment of the debt would be to cause a corresponding reduction both in credit balances and in advances in the books of the banks. Finally, if the debtor had a debit balance, and the creditor a credit balance, the payment would result in an increase both in advances and in credit balances.

7. Subscriptions by the General Public to War Loans, Exchequer Bonds, Treasury Bills, or other Securities Issued by the State.—When customers of banks subscribe to these issues from balances standing at their credit with their bankers, there will be no ultimate effect upon the aggregate credit balances, unless some of the subsequent disbursements by the Government ultimately reach accounts with a debit balance. In that case the result would tend to be a reduction in advances and also in credit balances. It is indisputable that a large amount of Government disbursements has reached accounts which before the war had a debit balance, representing an old loan of credit, transforming the debit into a credit; but, owing to the influence of other causes, the extent of this movement cannot be stated quantitatively. On the other hand, where the customer of a bank has a debit balance at the time he subscribes to one of these issues, or where, having previously had a credit balance, he borrows from his bank for the purposes of such subscription, bank advances and credit balances are both thereby proportionately increased.

Though customers' subscriptions to War Loans out of their own credit balances, do not, after Government disbursements, affect the aggregate of balances due to customers of banks, unless part of the disbursements find their way to accounts with debit balances, in actual practice some of the banks get more than their share of the return credits, for locality exercises a considerable influence in the final distribution of credits, even in peace time.

8. Subscriptions by Banks to War Loans, Treasury Bills,

Exchequer Bonds, or other Securities Issued by the Government.—The great increase in deposit liabilities (credit balances) during the war was primarily due to the manufacture of additional credit in various forms by the Government and the banks. When banks subscribe to War Loans direct, or make loans to the Government in any other direct or indirect form, they cause an expansion in the aggregate of the credit balances due to their customers, because, taking the banks collectively, they in net effect by such loans (after various transfer and re-transfer entries between bankers' balances and Public Accounts at the Bank of England) contract with the Government, in return for a certain rate or rates of interest, to credit the amount of their subscriptions to customers to whom payments are due from the Government for goods and services. This the banks are able to do because they are the generally accepted custodians of credit. It is obvious that the result of such action must be an expansion in the aggregate of the credit balances due to their customers.

The analysis of the intermediate effects of bank subscriptions to War Loans or other form of Government loan involves several stages. In the first instance the banks, in return for their subscriptions, receive a contract from the Government to pay them a certain rate of interest, which is determined according to the terms of the special security, while the security is usually itself marketable. The subscribing by the banks to a Government loan involves a transfer from bankers' balances at the Bank of England (included in the heading " Other Deposits ") to the balances in favour of the Government at the Bank of England (included in the heading " Public Deposits "). As soon as part or the whole of the transfer of credit is made, the Government draws upon its increased balances at the Bank in order to pay manufacturers and others part or the whole of the amounts it owes them for goods and services. These payments are made by warrants which are eventually, in the main, paid into the Joint Stock Banks by those of their recipients who are customers of such banks. The warrants are finally accounted for by the Bank of England, which debits " Public Deposits " with the amount, and at the same time credits the Joint Stock Banks in " Other Deposits " with the sums for which they had previously given credit to their customers. It would seem as if credit balance liabilities would be increased by the amount of bank subscriptions

to Government loans, and this in effect would tend to be so if none of the recipients of the Government warrants had debit balances with the Joint Stock Banks. In such cases bank ordinary advances would tend to decrease. The effect of these two opposed tendencies and other counteracting causes was clearly shown by the difference in the year 1915 between the amount of bank subscriptions to the War Loan of that year (apart from subscriptions to Treasury Bills) and the increase in the aggregate of credit balances. To the 4½ per Cent. War Loan issued in June, 1915, the banks subscribed about £200,000,000. Yet the increase in the deposit liabilities of banks during the year 1915 amounted to only £104,451,000. Advances to customers decreased by £38,000,000. These figures prove that some of the new credit was absorbed in liquidation of a certain amount of old private credit. Two factors that *tended* to operate to reduce credit balances during the war were reduced bank holdings of mercantile bills and the excess withdrawal over deposit of legal tender by customers.

It is not possible to state the exact amount of bank subscriptions to War Loans since the commencement of the war. To the first Loan, issued in 1914, bank subscriptions are said to have amounted to nearly £100,000,000 ; to the second Loan, issued in 1915, to about £200,000,000 ; and to the fourth Loan, issued in 1919, to £111,000,000 (amount stated by Chancellor of Exchequer). Possibly these amounts include subscriptions not only from British home banks but also from other banks with offices in this country. The third Loan, issued in 1917, included no direct applications from the banks, but it included a large amount (some estimates place it as high as £200,000,000) of credit granted by the banks to the public for the purpose of subscribing to the loan. Until those who borrowed from the banks for such purpose repay the advances, their subscriptions are, in effect, bank subscriptions. The greater part of such advances has now been repaid to the banks, but whatever the amount outstanding at any time, it would tend to reflect itself in a corresponding increase in the aggregate of credit balance liabilities of banks. On 31st December, 1919, the London Joint City and Midland Bank had only about £15,600,000, and the National Provincial and Union Bank of England about £7,600,000 of advances outstanding that had been made to assist customers in subscribing to War Loans.

What amount of investments the banks have sold since the commencement of the war, it is also impossible to estimate with any degree of accuracy. All that can be said in this matter is that the banks have sold foreign and Colonial securities when required to do so under the Government's schemes for the mobilization of securities during the war. Henceforth, the banks will probably gradually place on the market, in their desire to aid deflation, part of the investments they have unwillingly acquired during the war, when the market prices of the securities are high enough not to involve them in any great loss.

9. Bank Purchases of Securities from the Open Market.—When banks purchase securities from the open market they have necessarily to arrange, directly or indirectly, for the sellers to be credited for their sales or to make payment in the form of legal tender. Obviously, if the sellers elect, as is generally the case, to be credited in the books of the banks, the aggregate of credit balances will tend to increase. Should, however, the sellers elect to take legal tender from the banks, there will be no tendency for credit balances to increase as a result of the sales until some of the withdrawn legal tender finds its way back to the banks from circulation.

10. Loans to British Colonies, Allies, and Neutrals.—The effect of these upon the aggregate credit balances in the United Kingdom will vary with the character of the loan. (*a*) If the loan is remitted in the form of manufactured goods and the manufacturer receives payment indirectly in a War Loan issued by the British Government, there will be no change in the aggregate of credit balances. (*b*) If the manufacturer receives cash from the British Government, which cash that Government has borrowed, the effect on the aggregate credit balances will depend upon whether the recipient of the cash has a debit balance at his bank or not and the source of the borrowing by the Government. As already shown, if he has a debit balance, so far credit balances at his bank will not be increased : conversely, if he has a credit balance, there will tend to be a like increase in the credit balances at his bank. (*c*) If the loan is one for payment for purchases in the United States of America, and if it be effected by export of American securities from this country, then aggregate credit balances here might increase or might not increase according to the manner in which the

British Government acquired possession of the American securities exported. As a rule, ordinary bankers' credits in the United States will not affect credit balances in the United Kingdom.

11. Issues of Foreign Loans and Foreign Treasury Bills on the London Money Market.—(*a*) When these are taken up by the general public, the position as regards aggregate credit balances is similar to the issue of an internal public loan—that is, such issue will not tend, as a rule, to increase credit balances (*see* above (7) and subject to the same important exception). (*b*) When the subscription is made by banks there will be the converse tendency, namely, an increase in credit balances (*see* above (8)).

12. The Selling of Foreign Investments to Foreign Countries.—The effect of such sales upon aggregate credit balances in the United Kingdom will depend upon the source of the sale and the way in which payment is made. If the sale is made to agents in London of a foreign financial house, then floating foreign balances in London will be proportionately reduced, while the bank accounts of the sellers will be credited.

13. The Raising of Loans in Foreign Countries.—When a loan is floated in the United States of America and the credit thereby created in America is drawn against to pay for exports from the States to the United Kingdom, debits and credits of equal amounts will be created in the books of banks in the United Kingdom.

14. Bank Advances to the Trading and Manufacturing Community.—Earlier in the chapter, it was pointed out that when analysing the causes of variation in the aggregate of bank deposits it was necessary to bear in mind the difference between the London and provincial methods of recording loans of credit. In both cases it was shown that advances of any nature tended to reflect themselves in an increase of the aggregate of credit balances. A simple illustration is where manufacturer A obtains an advance of, say, £10,000 and draws cheques for, say, £2,000, £3,000, and £5,000 in favour of three raw material merchants, B, C, D, who are not indebted to their own banks. If B, C, D pay the cheques in to their banks to their own credit, obviously the aggregate of credit balances will tend to be increased by £10,000, the amount of the advance to A. As has been previously stated, to the extent that newly created credit is applied to the liquidation of old advances, so will

new advances not tend to cause an increase in the aggregate of credit balances.

15. Bills Discounted by Banks.—When a bank discounts one or more bills for a customer, it credits the proceeds to the customer's account. If the account be in credit, the aggregate of credit balances will tend to increase by the same amount. If the account have a debit balance, as large as the proceeds of the bills, the aggregate of credit balances will not tend to increase, but the amount of advances will tend to decrease.

16. The Issue of Currency Notes.—Whether an issue of Currency Notes will have any effect on the aggregate credit balance liabilities of banks will depend on the method of and conditions governing the issue. With reference to the present issue, to the extent the Joint Stock Banks take Currency Notes from the Bank of England (without exchanging gold or other notes for them) and retain them in their own reserves, so will their aggregate credit balance liabilities tend to be increased, provided that the Government draws on the credit created by the withdrawal of the Currency Notes from the Bank of England. When the Joint Stock Banks take Currency Notes from the Bank of England, their balances thereat are debited and the Currency Note redemption account credited with the amount of such notes withdrawn. The Government has continuously since the commencement of the issue drawn on the balance of the Currency Note redemption account and substituted its own securities for its drawings. To the extent that such drafts have passed to the credit of customers of Joint Stock Banks, so must the aggregate credit balances have tended to increase. Further mention of the effect of the present issue of Currency Notes on aggregate credit balances is made in the following pages when discussing the causes that give rise to an increase in the cash reserves of the Joint Stock Banks.

17. Bank Impersonal Accounts.—Like any other business institution, banks, in making up their books for balance sheet purposes, have to include the balances of a certain number of General Ledger Accounts which are no concern of individual customers of the banks. In the case of the " Liabilities " side of the balance sheet, they are included in the heading " Current, Deposit, *and other* Accounts." What proportion the balances of " Other Accounts " bears to the aggregate of the balances of deposit and

current accounts it is impossible to state, but it may be taken for granted that it is usually relatively very small. Some of these "Other Accounts" are part of what the banks term the "hodge podge." The "hodge podge" varies considerably in the case of those banks that "window dress" their balance sheets at half-year or year ends.

Summing up in the matter of the influences that have caused the increase of £1,328,000,000 in the aggregate of credit balance liabilities of banks since the year 1913, it may be said that part of the increase is due to increase in Cash Reserves (the effect of Ways and Means Advances and the issue of Currency Notes), part to subscriptions by the banks to the War Loans, part to bank purchases of Treasury Bills, and part to an increase in advances to merchants, manufacturers, and others for trading purposes. Advances have naturally increased most since the termination of hostilities and revival of trade. There has been a great demand for additional credit owing to increased prices and labour costs. Part of the increase in advances during the war was due to bank loans to customers to enable them to subscribe to War Loans.

During the early months of 1920 there was a further increase in advances to customers for trade requirements, but from about the month of July, 1920, the movement has been stopped, owing to the Government desire for gradual deflation and a recognition by the banks of the artificial cash basis on which the great increase of credit has been erected during the war. Reduction in Ways and Means Advances and in the fiduciary part of the Currency Note issue have brought home to the banks that their edifice of new credit has its foundations on moving sands.

The table on page 74 shows the increase in Bank Deposits since the end of 1913, according to *The Economist.*

From this table it will be observed that bank deposits aggregated to £2,356,271,000 at the end of 1919. But according to *The Statist* the amount of deposits at the end of 1919, was £2,398,831,000. The difference of about £42,000,000 is nearly accounted for by *The Statist* including in its combined balance sheet the figures of the Yorkshire Penny Bank and the Co-operative Wholesale Society Bank, which banks *The Economist* omits from its compilation. The deposits of these two institutions amounted to about £38,000,000 at the end of 1919.

BANK DEPOSITS (EXCLUDING BANK OF ENGLAND AND SAVINGS BANKS)
(*Extracted from "The Economist"*)
(000's omitted)

Year.	Joint Stock Banks of England and Wales.	Joint Stock Banks of Scotland.	Joint Stock Banks of Ireland.	Private Banks.	Total.	Increase per annum.
	£	£	£	£	£	£
1913 .	809,352	125,887	70,657	27,090	1,032,986	46,563
1914 .	895,561	132,504	74,501	32,874	1,135,440	102,454
1915 .	992,555	140,568	77,722	32,891	1,243,736	108,296
1916 .	1,154,877	166,620	83,746	39,183	1,444,426	200,690
1917 .	1,365,297	196,538	99,310	44,697	1,705,842	261,416
1918 .	1,583,412	222,054	131,610	51,271	1,988,347	282,505
1919 .	1,874,184	259,610	166,231	56,246	2,356,271	367,924
1920 .	1,961,527	279,228	200,441	50,865	2,492,061	135,790

In connection with the above figures it has to be borne in mind that the total increase shown does not represent exact true growth, for Joint Stock Banks have at times absorbed private banks which did not publish balance sheets.

The following principles bearing on the relationship between bank credit and customers' deposits were laid down by a member[1] of Section F of the British Association for the Advancement of Science, in an address to a meeting of the Section held in Newcastle in September, 1916—

(*a*) It is through credit expansion that banking deposits mainly increase in normal times. During the ten years, 1904–1913, banking deposits increased on an average about £30,000,000 a year. Of this increase, about £27,000,000 was due to bank credit expansion, the remaining £3,000,000 or less being due to excess deposit over withdrawal of legal tender, mainly gold, by customers.

(*b*) So long as the banks continue to grant *additional* credit to the community so long must their deposit liabilities tend to increase correspondingly, for in banking phraseology every debit has its contra credit entry or entries somewhere in the books of the banks of the United Kingdom, unless the debit represents a permanent withdrawal of legal tender. About 90 per cent. of bank deposit liabilities is the result of the growth in banking credit.

(*c*) Bankers are fully conscious that when they make loans to their customers they are only making book transfer entries in the accounts of their customers and of themselves, for the banks are

[1] Mr. A. H. Gibson.

the generally accepted custodians of credit. Individually, howeve., banks have to regulate the total amount of their various classes of loans by the amount of their cash reserves, that is legal tender they have in hand and their balances at the Bank of England.

(*d*) All the leading banks keep a large credit balance at the Bank of England, partly to settle final differences between themselves due to cross crediting of customers' drawings, and partly to provide them with additional legal tender when they are called upon to meet excessive withdrawal over deposit of legal tender by their customers.

(*e*) Should a bank grant ***additional*** credit at a rate greater than the increase in its customers' deposits, it would find its cash reserves gradually pass into the control of other banks. Its customers' deposits, and consequently its cash reserves, are largely dependent on the relative rate to itself at which other banks are creating ***additional*** credit, but locality often exercises considerable influence in the final distribution of credits.

(*f*) To the extent that existing deposits are transferred to accounts with debit balances, that is to say, to people who owe money to their banks, the total amount of deposits is reduced, and to the extent that new loans of credit are transferred to accounts with debit balances, the total amount of deposits will not increase through the creation of the new credit, because old credit will be liquidated by the transfer of the new credit.

(*g*) The business of banks under modern conditions of credit is of a twofold character. They transfer existing deposits, that is customers' credit balances, in whole or in part, to the order of their customers, and they create additional deposits by increasing their loans of credit.

(*h*) The banks render very great services to the community, for the transfer of existing credit and the creation of new credit is absolutely essential to modern production.

(*i*) The great economic distinction between the Government in war time and the public in peace time obtaining grants of credit from the banks is that the former uses the grant in order to obtain and consume goods and services for the destructive purposes of war ; but the latter in order to increase productive power,[1] and

[1] Banks, by making loans for the purpose of part payment of wages and cost of materials, and financing foodstuffs, materials, and finished goods whilst in transit overseas, and in some cases for some extended time after arrival, enable producers, manufacturers, and traders to employ a greater proportion of their own resources in land, buildings, plant, etc.

consequently to increase the available supply of goods at the disposal of the community in the future.

(*j*) Seeing that public subscriptions to War Loans simply mean an exchange or transference in ownership of bank deposits, the transferors on each occasion of transfer receiving Government securities granting a lien on the production and services of posterity, it is obvious that the amount of internal War Loans that may be raised by an advanced community under modern banking conditions is almost unlimited, provided the terms of issue and methods of collection are made sufficiently attractive to the public. Given time for alternate collections and disbursements, I can conceive of the United Kingdom being able to mortgage posterity to the extent of at least £10,000,000,000, if necessary.[1]

Cash in Hand, at Bank of England, Etc.

The following table shows the annual increases in the so-called Cash Reserves[2] of the Joint Stock Banks since 1913—

Cash in Hand, at Bank of England, Etc.

At 31st December.	Amount.	Increase.
	£	£
1914 . . .	221,000,000	69,000,000
1915 . . .	224,000,000	3,000,000
1916 . . .	319,000,000	95,000,000
1917 . . .	320,000,000	1,000,000
1918 . . .	374,000,000	54,000,000
1919 . . .	423,000,000	49,000,000
Increase for six years . .		£271,000,000

Banks do not in all cases separate "Cash in hand and at Bank of England" from "Money at Call and at Short Notice." In the above table an adjustment has been made for each year on the

[1] This statement was made at a time when Government borrowings on war account had not quite aggregated to £2,400,000,000, and occasioned much press discussion. There was a consensus of opinion that the estimate of £10,000,000,000 was an impossible amount for the United Kingdom to raise. For the period 1st August, 1914, to 31st March, 1920, Government borrowings on account of the war amounted to nearly £7,200,000,000. If the war had lasted for two years longer than its actual period of duration, Government borrowings on account thereof must have inevitably exceeded £10,000,000,000.

[2] Usually described on balance sheets as "Cash in hand and at Bank of England." Some banks use the expression "Cash in hand and *with* the Bank of England"; other banks, "Cash in hand and *in* the Bank of England."

assumption that the experience of banks that do separate these items, one from the other, is that of all the banks. Reference to the combined balance sheet already given will show that when the above adjustment is not made, "Cash in hand and at Bank of England" (including "Money at Call and at Short Notice" in cases where no separation is made of this latter item), amounted to £173,000,000 on 31st December, 1913, and £443,000,000 on 31st December, 1919; an increase of £270,000,000 in six years, which is almost the same increase shown in the above table. The interesting question now arises: To what factors was this very abnormal increase due? It is advisable to deal with this important matter at some length, in fact to investigate the causes of the great increase in the cash reserves of the Joint Stock Banks since the commencement of the war.

In the first place, in considering the aggregate cash reserves of Joint Stock Banks, it is necessary to bear in mind that the so-called reserves they keep with the Bank of England are not specifically earmarked or set aside in legal tender. Such reserves represent simply credit liabilities of the Bank of England to the Joint Stock Banks, and possess no priority as to repayment over the Bank's other deposit liabilities. The expression "Cash in hand and at Bank of England" found on the balance sheets of the Joint Stock Banks really means "legal tender in our strong rooms, safes, and tills, and balance standing to our credit in the books of the Bank of England," and usually also includes certain other items referred to later. Just in the same way as traders have come to speak of the balance standing to their credit at a Joint Stock Bank as "Cash at (or with, or in) Bank," so the Joint Stock Banks have come to term the balance standing to their credit at the Bank of England as "Cash at (or with, or in) Bank of England."

A second point to bear in mind is that it is not possible to state the amount of legal tender held by the Joint Stock Banks themselves separately from the amount of their balances at the Bank of England, for the Joint Stock Banks do not make this separation on their balance sheets. A few of the banks (mainly small banks) still even follow the old practice of lumping together for balance sheet purposes the items "Cash in hand," "Balance at Bank of England," "Money at Call and Short Notice." It may be here noted that prior to the war the aggregate of bankers' balances at

the Bank of England was estimated by leading financial authorities to average between £20,000,000 and £25,000,000, and at times the amount was thought to exceed the amount of the Bank of England's own reserve in its banking department.

Whilst it is not possible to estimate even approximately the present amount of legal tender in the hands of the Joint Stock Banks separately from the aggregate of their balances at the Bank of England, it may be said with certainty that the major part of the increase in the cash reserves of Joint Stock Banks during and since the recent war has been due to considerable increases in their balances at the Bank of England and the issue of Currency Notes. This will be obvious from the following review of the different ways in which the cash reserves of Joint Stock Banks may be increased.

Taking the Joint Stock Banks as one unit, their cash reserves may at any time be increased in any of the following eight ways—

1. By an excess deposit over withdrawal of legal tender by their customers. At certain seasons of the year this happens temporarily in peace times, but it is certain that during and since the recent war there has been an excess withdrawal over deposit of legal tender. It is well known that during the war there was an almost continuous drain of legal tender from the Joint Stock Banks, owing to the general rise in commodity prices and increased wages absorbing an additional amount of legal tender into circulation.

2. By the Joint Stock Banks increasing their own reserves of legal tender by withdrawals of legal tender from the Bank of England, and having their balances at the Bank of England maintained or increased by any of the credit operations enumerated in the following paragraphs, 3, 4, 5, 6. This method was well illustrated during the war by the indirect effects of the issue of Currency Notes on Joint Stock Bank cash reserves. This is an exceedingly interesting matter. As the Joint Stock Banks take Currency Notes from the Bank of England, their balances thereat are, of course, debited with the amount. If they keep the withdrawn notes in their own strong rooms, their aggregate cash reserves are not for the time being reduced by the withdrawal. But as soon as they proceed to pay out the notes to their own customers, their aggregate cash reserves will tend to decrease, until such

time as the Government draws on the credit created by the withdrawal of the Currency Notes from the Bank of England, and substitutes its own securities in the Currency Note Redemption Account. The Government drafts will first mainly pass to the credit of customers of Joint Stock Banks, but later, in the course of clearance, will be credited to the balances of the Joint Stock Banks at the Bank of England. The following illustration shows the operation in simple detail. Let it be supposed the Joint Stock Banks take, say, £10,000,000 in Currency Notes from the Bank of England (for which their balances are debited), £7,000,000 of which they soon afterwards pay out to their customers, and that the Government uses the £10,000,000 credit created by the withdrawal of the notes from the Bank of England : in other words, draws to that amount on the cash balance of the Currency Note Redemption Account ; then the credit and debit operations of the various transactions will be as follows—

	£		£
Balances of Joint Stock Banks at Bank of England debited . . .	10,000,000	Cash Balance (at Bank of England) of Currency Note Redemption Account credited . . .	10,000,000
		Cash in hand of Joint Stock Banks increased .	10,000,000
Cash in hand of Joint Stock Banks reduced by customers' withdrawals	7,000,000		
Balances of customers of Joint Stock Banks debited	7,000,000		
Cash Balance of Currency Note Redemption Account debited . . .	10,000,000	Public Accounts credited	10,000,000
		Government Drafts credited to customers of Joint Stock Banks. .	10,000,000
Public Accounts debited.	10,000,000	Government Drafts credited to Joint Stock Bank balances at Bank of England	10,000,000

It is easily seen that the net effect of the above operations is an increase in the so-called cash reserves of the Joint Stock Banks by £3,000,000, and a corresponding increase in the credit balance liabilities of the Joint Stock Banks to their customers. The following

rule may, therefore, be laid down as to the effect of the Currency Note issue on the cash reserves of the Joint Stock Banks. "To the extent the Joint Stock Banks take Currency Notes from the Bank of England (without exchanging gold or other notes for them) and retain them in their own reserves, so will their aggregate cash reserves tend to be increased, provided the Government draws all the credit created by the withdrawal of the Currency Notes from the Bank of England." The intermediate transactions at the Bank of England may be mentally eliminated by considering the Government to hand to the Joint Stock Banks £10,000,000 in Currency Notes (legal tender bearer securities), in return for the Joint Stock Banks crediting £10,000,000 to their customers to whom the Government is indebted for goods and services, and the Joint Stock Banks paying out £7,000,000 of these notes to the same or other customers.

During the course of the war, and also since the declaration of peace, the Government has repeatedly drawn on the cash balance of the Currency Note Redemption Account, to the aggregate extent of about £337,000,000, up to 31st December, 1919. A week previously, at 24th December, Government securities held in the Redemption Account reached their maximum amount, namely, about £339,000,000. By 25th May, 1921, the amount had been reduced to about £298,000,000, securities for the difference having been redeemed.

No near estimate can be given with certainty of the extent to which the issue of Currency Notes has actually increased Joint Stock Bank cash reserves since the commencement of the war. It may, however, be roughly estimated that of the increase of about £271,000,000 in the aggregate cash reserves between 31st December, 1913, and 31st December, 1919, from £80,000,000 to £100,000,000 was due to the issue of Currency Notes, for reasons already advanced.

3. By the Bank of England granting credit to bill-brokers and other borrowers to meet loans called in by the Joint Stock Banks. If for any reason a Joint Stock Bank wishes to increase its "Cash in hand and at the Bank of England," the usual procedure is to call in part of its loans to bill-brokers or other market borrowers, thereby forcing the latter to borrow from the Bank of England, (in the absence of being able to obtain the credit elsewhere). The operation simply involves cross-transfer entries in the books of

the Bank of England. Bankers' balances are credited and loans or discounts debited in the books of the Bank of England.

In the Weekly Returns of the Bank of England, bankers' balances are included under the heading "Other Deposits," and loans and discounts (to borrowers other than the Government) under the heading "Other Securities." Loans by the Bank of England to the Government come under the heading "Government Securities," and balances due to the various departments of the Government under the heading "Public Deposits."

Owing to the great increase in the cash reserves of Joint Stock Banks caused by other influences during the war, it is certain that no material part of the aggregate increase between 31st December, 1913, and 31st December, 1919, was due to increased borrowings by bill-brokers and others at the Bank of England at the latter date as compared with at the former date to meet calls by the Joint Stock Banks. The item "Other Securities" in the Weekly Returns of the Bank of England showed an increase of £29,900,000 for the two weeks ending 31st December, 1919, as against an increase of £25,100,000 for the two weeks ending 31st December, 1913. At the former date the Joint Stock Banks strengthened their balances at the Bank of England by omitting to renew maturing Treasury Bills, an action the Government had to meet by means of Ways and Means advances.

4. By the Bank of England granting credit direct to the Joint Stock Banks. Such an increase reflects itself in the item "Other Deposits," and *per contra* in the item "Other Securities." Occasionally, some of the banks obtain such a credit at the Bank of England at half-year ends to strengthen their balance sheet cash reserve position, and also in times of crisis.

The large payments the Joint Stock Banks had to make to the Bank of England on account of the War Loan issued 12th January–16th February, 1917, caused some of them to borrow temporarily from the Bank of England, but the major part of such borrowings was quickly repaid after Government disbursements of the proceeds of the War Loan.

5. By the Bank of England granting credit to other customers, who transfer the whole or part of it to the accounts of the Joint Stock Banks at the Bank of England. The case already mentioned under 3, of bill-brokers being driven to borrow from the Bank of

England to meet loans called in by the Joint Stock Banks, is one illustration of the creation and transfer of new credit leading to the augmentation of bankers' balances at the Bank of England. There are many other borrowers from the Bank of England who liquidate indebtedness to the Joint Stock Banks by the transfer of advances made to them by the Bank of England. Such advances usually reflect themselves in an increase in the items "Other Securities" and "Other Deposits" in the Weekly Returns of the Bank of England, though current transfers by bankers to Public Accounts may for the time being prevent "Other Deposits" showing approximately the same increase as "Other Securities." It may be laid down as a general principle that any material increase in "Other Deposits" is generally due to an increase in bankers' balances at the Bank of England.

6. By the Joint Stock Banks paying in to their accounts at the Bank of England drafts drawn on the Bank of England. These drafts may be drawn on credit balances or against advances made by the Bank of England, and may represent amounts due direct to the Joint Stock Banks in the first instance, or to customers of the Joint Stock Banks. In the latter case, the Joint Stock Banks will first have given credit to their customers for the amounts of the drafts.

During the course of the war, the Joint Stock Banks paid into the Bank of England to their credit an enormous number of drafts representing a stupendous amount of Government war disbursements; but these drafts did not cause a corresponding increase in Joint Stock Bank balances at the Bank of England, because they had in the main been drawn against funds which the Joint Stock Banks had first transferred to the Public Accounts, representing subscriptions by themselves and their customers to War Loans, and the collection of taxation. The amount disbursed by the Government in the United Kingdom has, however, been greater than the amount the Joint Stock Banks have had to pay to Public Accounts, and the difference is consequently one of the causes of the great increase in the balances of the Joint Stock Banks at the Bank of England since the commencement of the war. The difference has been met by loans from the Bank of England to the Government and also, there is every reason to believe, at certain periods by temporary advances from the Joint Stock

Banks to the Government, the Bank of England acting as intermediary. (See below.)

7. By the Joint Stock Banks making temporary loans to the Government through the medium of the Bank of England, the Government using such loans for war disbursements, and the Joint Stock Banks in their balance sheets including them partly under the heading " Cash in hand and at Bank of England," instead of wholly under the heading " Money at Call and Short Notice." This form of Government borrowing was certainly not in operation before the war, but the following are the reasons for believing it to have been in operation during 1916–1919—

(*a*) Since the commencement of 1916, and up to 22nd July, 1919, the Bank of England (generally understood to be acting on behalf of the Treasury) took spare balances from the other banks at fixed rates of interest, usually at three days' notice. *The Statist,* in its issue dated 8th January, 1916, announced : " It is understood that the Government is now borrowing indirectly from bankers, for short periods, at 4½ per cent. for Ways and Means."

(*b*) Unless such form of borrowing was in operation, and part of the loans were considered as cash by the banks, no explanation can be given for the major part of the great increase of about £95,000,000 in the cash reserves of the Joint Stock Banks during 1916, for the " Other Deposits " of the Bank of England (under which heading bankers' balances are included) only increased by £14,700,000 (from £112,000,000 to £126,700,000) during that year. Part of the increase in cash reserves would be due, as already stated, to additional reserves of Currency Notes in hand by the Joint Stock Banks, but it is improbable that this cause accounts for more than £20,000,000 or so of the increase of £95,000,000 that took place during the year 1916.

(*c*) The Government Revenue Returns show that the additional amount temporarily borrowed on the credit of Ways and Means Advances during 1916 was considerably greater than the increase in the item " Government Securities " in the Weekly Returns of the Bank of England, though other sources of temporary borrowings may account for a large part of this difference. It was not until April, 1920, that the Treasury in its weekly returns made a separation of Ways and Means Advances by the Bank of England from those by Public Departments. Since the separation was made the

latter have been shown to be of large and varying amounts. Presumably Ways and Means Advances by Public Departments mainly represent sums due or past due to the spending departments from the Government, but part may represent advances actually made out of balances standing to their credit at the Bank of England (under the heading of "Public Deposits").

(*d*) Financial authorities accustomed to reading the meanings of the broad fluctuations in the Weekly Returns of the Bank of England have suggested that in the method of accounting in the books of the Bank of England for spare balances borrowed from other banks, which has so far not been disclosed, may be found an explanation of several otherwise inexplicable movements that took place in the items of the Weekly Returns of the Bank of England during the issue of the 5 per Cent. War Loan (12th Jan.–16th Feb., 1917), and for several weeks after.

The Economist, in its special banking issue of 19th May, 1917, made the following interesting comment relative to the interpretation of recent Bank Returns—

> The figures published weekly by the Bank of England are at all times full of snares for the unwary investigator, and are more so than ever in war time, owing to the very complicated business that has to be done by the Bank, and the consequent cross currents that are concealed behind the inarticulate reticence of the items in its Return. A fresh complication has been introduced during the year under review by the inauguration of the system by which the Bank of England borrows from the other banks. In old times, when the Bank borrowed, it deducted the sum so taken from its securities on one side and its deposits on the other. If, as is presumably the case, it does so still, there is an unknown factor which makes the figures more than ever a puzzle, since it is in the power of the other banks at any time to increase them on both sides by taking their money back. Any future historian who relies too closely on the Bank's figures for information is thus likely to flounder up to his neck.

It is usual for Government borrowings from the Bank of England to be reflected in a corresponding increase in the item "Government Securities," but no such movement can be detected on account of Government borrowings of bankers' spare balances. It appears probable that the system of accounting for borrowings of bankers' spare balances was so arranged as not to increase the deposit liabilities of the Bank of England and reduce its percentage reserve. If the Government borrowed, say, £5,000,000 weekly from the Joint Stock Banks through the medium of the Bank of England, repayable at short periods, and continuously disbursed such borrowings, neither "Other Deposits" nor "Public Deposits" in the

Weekly Returns of the Bank of England need necessarily disclose the transactions. The series of transactions might be as follows: Bankers' balances debited £5,000,000, Public Deposits credited £5,000,000, and *memorandum* of loan made in books of Bank of England. After disbursement, Bankers' balances credited £5,000,000 and Public Deposits debited £5,000,000. This cycle could be repeated as often as agreed upon by the Government, the Bank of England, and the Joint Stock Banks.

8. If reference be made to the combined balance sheet already shown, it will be observed that the cash reserves of the Joint Stock Banks are given under the heading " Cash in hand, at Bank of England, etc." In the abbreviation, " etc.," is to be found a further explanation of part of the great increase in the so-called cash reserves of the Joint Stock Banks since 1913. This mystic word represents what is known by bank accountants as the " hodge podge " in making up balance sheets at any time. Generally speaking, the word does not appear on balance sheets, the expression " Cash in hand " being intended to include its sins. " Etc." has increased considerably since 1913, mainly owing to the influence of the great rise in prices. In the case of the large banks it mainly represents balances with, and cheques in course of collection on, other banks in the United Kingdom, and cheques, drafts, etc., in transit, and may be looked upon as cash in the course of a few days. Following a recommendation made by the Committee on Currency and Foreign Exchanges after the War, in their interim report published on 29th October, 1918, several of the larger banks are now showing this important item separately on their balance sheets (but not to the detailed extent suggested by the Committee). In the case of one large bank, at 31st December, 1920, the item represented about 26 per cent. of the composite cash amount, in the case of another bank about 17 per cent. The great rise in prices since 1915 naturally caused the banks to increase their balances with other banks for clearing and agency purposes, and also caused a considerable increase in the aggregate face amount of cheques in course of collection and transit. It is possible, though not probable, that some banks include the above-named item under the heading " Money at call and at short notice."

The following particulars relating to the estimated amount of currency in circulation, and also held by the banks, were given

by the Chairman (the Right Hon. R. McKenna) of the London Joint City & Midland Bank, Limited, in the course of his address to the shareholders at the annual meeting of the Bank held on 29th January, 1920—

> It is estimated that in 1914 the total amount of currency in circulation, i.e. gold, silver, copper coin, and bank notes, was £128,000,000. This figure represents the total amount of currency held by the public, but does not include currency held by the banks. To-day the corresponding figure is estimated at £393,000,000, an increase of £265,000,000, or 207 per cent. As I am giving these figures I may as well state here that the estimated amount of currency held by the banks in 1914 was £75,000,000, and in 1919 £191,000,000, an increase of £116,000,000, or 154 per cent.

Presumably the above figures refer to currency at 31st December, 1913, or 30th June, 1914, and 31st December, 1919.

Summing up in the matter of Joint Stock Bank cash reserves, the great increase in such reserves since 1913 is to be accounted for by expansion of credit by the Bank of England and the ultimate transfer of the major part of it to the accounts of the Joint Stock Banks at the Bank of England, possibly the borrowings by the Government of bankers' spare balances and subsequent disbursement of such borrowings, the building up of additional legal tender reserves in hand by the Joint Stock Banks in the form of Currency Notes and Currency Note Certificates (and the use by the Government of the credit thereby created) and Bank of England Notes, and increases in various other items generally considered as cash and referred to above in paragraph 8. No part of the increase has been due to excess deposit over withdrawal of legal tender by customers of Joint Stock Banks, for, on the contrary, there was an almost continuous absorption of legal tender by the public since the commencement of the war, and up to about July, 1920, owing to rapidly increasing commodity prices and wages.

The increase of £69,000,000 in the cash reserves of the Joint Stock Banks during the year 1914 is accounted for by the increase in the liability "Other Deposits" of the Bank of England, and the addition (in the form of Currency Notes) of many millions to the legal tender in hand by the Joint Stock Banks, during that year. The very small increase of £3,000,000 in the cash reserves during the year 1915 is accounted for by a decrease of many millions in "Other Deposits" at the Bank of England, and the addition of lesser millions to the legal tender in hand by the Joint Stock Banks, during that year. The great increase of £95,000,000 in

the cash reserves of the Joint Stock Banks during the year 1916, and part of the increase of £54,000,000 during the year 1918, may be mainly accounted for by Government borrowings of bankers' spare balances, and the addition (in the form of Currency Notes) of many millions to the legal tender in hand by the Joint Stock Banks, during those years. Part of the increases for these years was due to an increase in "Other Deposits" at the Bank of England. The increase of £49,000,000 for the year 1919 is accounted for by the Joint Stock Banks omitting to renew maturing Treasury Bills at the end of the year (an action the Government had to meet by means of Ways and Means Advances), and an addition to Currency Notes in hand. Increases in various other items, usually considered as cash by the banks, and already referred to, also accounted for some part of the increase in cash reserves since 1913.

Money at Call and at Short Notice

The following table shows the annual variations in the amount of Money at Call and at Short Notice since 1913—

Money at Call and at Short Notice

At 31st December.	Amount.	Increase.
	£	£
1914 . .	122,000,000	24,000,000 (decrease)
1915 . .	101,000,000	21,000,000 (decrease)
1916 . .	140,000,000	39,000,000
1917 . .	215,000,000	75,000,000
1918 . .	256,000,000	41,000,000
1919 . .	171,000,000	85,000,000 (decrease)
	Increase for six years .	£25,000,000

As already stated, when discussing the subject of Cash Reserves, banks do not in all cases separate "Cash in hand and at Bank of England" from "Money at Call and at Short Notice." In the above table an adjustment has been made for each year on the assumption that the experience of banks that do separate these items, one from the other, is that of all the banks. Reference to the combined balance sheet already given, in the figures of which the above mentioned adjustment is not made, shows that the increase for the six years 1914–1919 in the "Money at Call and at Short

Notice" is £25,839,000, about the same amount as that shown in the table on page 87 where an adjustment has been made for each year.

The decrease of £45,000,000 in "Money at Call and at Short Notice" for the two years ending 31st December, 1915, was due to the stagnant state of the bill market and short loan fund generally. Apart from the desire of the banks during these two years to augment their balances at the Bank of England as much as possible, there was a reduced demand for short loans as a consequence of war conditions.

The great increase of £155,000,000 for the three years ending 31st December, 1918, was undoubtedly due in the main to the system under which the Government through the medium of the Bank of England borrowed, since the commencement of 1916, the spare balances of other banks at fixed rates of interest for short and varying periods. This matter was fully explained when discussing the reasons for the increase of the Cash Reserves of the banks during the war. The cycle of transfers was: (1) The banks placed part of their spare balances at the Bank of England at the disposal of the Government. (2) The Government immediately disbursed this credit. (3) The drafts drawn by the Government were, in the main, paid into the Joint Stock Banks by their own customers. (4) The drafts so paid in were sent by the Joint Stock Banks to the Bank of England to credit of their own balances. Net result: Rehabilitation of bankers' balances at Bank of England, but increase of "Money at Call and at Short Notice."

The decrease of £85,000,000 for the year 1919 in "Money at Call and at Short Notice" may be wholly or mainly accounted for by the Government ceasing, as from 22nd July, 1919, to borrow bankers' spare balances through the medium of the Bank of England.

If the amount of Money at Call and at Short Notice be added to Cash in hand and at Bank of England, the increase is £296,000,000 for the six years 1914-1919, according to the figures that have already been given for the items considered separately. If the figures be taken from the aggregate balance sheet compiled by *The Economist,* the increase is £293,000,000, which amount represents an increase of exactly 100 per cent. on the amount of £293,000,000 at 31st December, 1913. Part of the difference between the figures

taken from *The Statist* and *The Economist* is due to the former including and the latter omitting in their combined balance sheet the figures of the Yorkshire Penny Bank and those of the Co-operative Wholesale Society Bank.

INVESTMENTS

The following table shows the annual variations in the amount of Investments held by the banks since 1913—

INVESTMENTS

At 31st December.	Amount.	Increase.
	£	£
1914 . .	241,742,000	30,808,000
1915 . .	441,052,000	199,310,000
1916 . .	436,660,000	4,392,000 (decrease)
1917 . .	431,962,000	4,698,000 (decrease)
1918 . .	510,580,000	78,618,000
1919 . .	600,035,000	89,455,000
	Increase for six years .	£389,101,000

The banks are known to have subscribed directly to the various War Loans close on £400,000,000; possibly some part of this amount represents subscriptions by banks which are not British home banks, but banks with London offices operating in foreign and colonial countries. To the first loan, issued in 1914, bank subscriptions are said to have amounted to nearly £100,000,000; to the second loan, issued in 1915, to about £200,000,000; and to the fourth loan, issued in 1919, to £111,000,000. The third loan included no direct subscriptions from the banks. The first, third (excepting that part on which Income Tax was compounded), and fourth loans were issued at a discount. No estimate can be given of the amount subscribed by banks to Exchequer Bonds and National War Bonds, but it must be relatively small to their aggregate subscriptions to War Loans. The Joint Stock Banks are known to have disposed of, during the war, the greater part of the foreign and Colonial investments they held at the commencement of the war, in support of the Government scheme for the mobilization of foreign and colonial securities.

A few banks include Treasury Bills under the heading "Investments," instead of under the heading "Bills Discounted," but

such practice has diminished with the progress of the amalgamation movement.

According to *The Economist*, the increase during the six years 1914–1919 in the amount of Investments held by the British home banks was £411,000,000.

Bills Discounted

The following table shows the annual variations in the amount outstanding of bills discounted since 1913—

At 31st December.	Amount.	Increase.
	£	£
1914 . .	161,000,000	7,000,000 (decrease)
1915 . .	127,000,000	34,000,000 (decrease)
1916 . .	237,000,000	110,000,000
1917 . .	368,000,000	131,000,000
1918 . .	444,000,000	76,000,000
1919 . .	376,000,000	68,000,000 (decrease)
	Increase for six years .	£208,000,000

Banks do not in all cases separate "Bills Discounted" from "Advances." In the above table an adjustment has been made for each year on the assumption that the experience of banks that do separate these items, one from the other, is that of all the banks. When no such adjustment is made, the increase in bills discounted for the six years 1914–1919 appears as £225,000,000, which amount is £17,000,000 more than the increase shown in the above table. A few banks include Treasury bills under the heading "Investments," but such practice has diminished with the progress of the amalgamation movement.

The decrease of £41,000,000 in bills discounted for the two years ending 31st December, 1915, was obviously due to the drastic curtailment of home and foreign trade due to war conditions. The increase of £317,000,000 for the three years ending 31st December, 1918, may be attributed wholly to bank purchases of Treasury bills. The amount of Treasury bills outstanding on 31st December, 1918, was £1,094,740,000. During 1919 there was a considerable increase in the amount of mercantile and bank bills purchased, following the re-establishment of home and foreign trade at prices considerably higher than those ruling prior to the war. During

this year, however, particularly towards its close, the banks omitted to renew a large amount of maturing Treasury Bills, and the effect of such omission, as the above table shows, was a net reduction of £68,000,000 in the amount of all classes of bills.

Advances

The following table shows the annual variations in the amount of outstanding advances since 1913—

Advances

At 31st December.	Amount.	Increase.
	£	£
1914 . .	536,000,000	30,000,000
1915 . .	498,000,000	38,000,000 (decrease)
1916 . .	472,000,000	26,000,000 (decrease)
1917 . .	549,000,000	77,000,000
1918 . .	615,000,000	66,000,000
1919 . .	1,007,000,000	392,000,000
	Increase for six years .	£501,000,000

As previously stated, when discussing the subject of bills discounted, banks do not in all cases separate the amount of bills discounted from the amount of outstanding advances. In the above table an adjustment has been made for each year on the assumption that the experience of banks that do separate these items, one from the other, is that of all the banks. When no such adjustment is made, the increase in the amount of advances for the six years 1914–1919 appears as £484,000,000, which amount is £17,000,000 less than the increase shown in the above table.

The increase of £30,000,000 in the amount of advances for the year 1914 was partly due to advances made in 1914, before the commencement of the war in August of that year, and partly to advances made after the outbreak of the war to customers who were feeling financial pressure owing to non-receipt of sums due to them from both home and abroad, in the latter case owing to the breakdown of the foreign exchanges, and also to certain of their foreign debtors having become enemies of this country. The decrease of £64,000,000 for the two years ending 31st December, 1916, was due to the fact that the conditions brought about by the war had made the Government become the largest trader in the

country. Government debts displaced to a considerable extent ordinary trade debts. Moreover, there was a considerable falling off in certain directions of foreign trade, so far as the ordinary trader was concerned.

The increase of £77,000,000 in the amount of advances during the year 1917 was due to the very large amount of advances made by the banks to customers to enable them to subscribe to the great War Loan issued at the commencement of that year. The increase of £66,000,000 during the year 1918 may be attributed to the rapidly increasing commodity prices compelling traders and others to seek additional accommodation from the banks, notwithstanding large trading profits. In many cases traders were driven to seek loans because in a spirit of patriotism they had in the year 1917 applied too great a proportion of their liquid resources to subscribing to the War Loan of that year, underestimating the rise in commodity prices that was to follow.

The unprecedented increase of £392,000,000 in the amount of advances during the year 1919 was due to the revival of home and foreign trade after the conclusion of peace, at rapidly increasing prices and cost of labour; manufacturing and trading concerns requiring considerably more floating capital to run their businesses than they did in pre-war times. Congestion of transport and speculation were also contributing factors. The year 1920 opened with all these causes in full operation, a boom in new issues, and only by the imposition of the 7 per cent. Bank Rate, on 15th April, was a salutary check given to further inflation. About this time the banks began to refuse all new demands for advances for purposes other than for necessary trade, and called in some outstanding loans which were being employed in unduly withholding stocks from the markets, or in other speculative channels. The banks had at last recognized the artificial cash basis of the enormous amount of bank credit created during the war, and the increasing danger of any further inflation.

If the amount of bills discounted be added to the amount of advances, the increase is £709,000,000 for the six years 1914–1919, according to the figures that have already been given for the items considered separately. If the figures be taken from the aggregate balance sheet compiled by *The Economist*, the increase is £683,000,000. According to *The Economist*, the amount outstanding

at 31st December, 1913, was £683,000,000, so the increase for six years is exactly 100 per cent. It is an interesting coincidence that Cash in Hand, at Bank of England, Money at Call, and at Short Notice, added together, also increased exactly 100 per cent. during the same period. Part of the difference between the figures taken from *The Statist* and *The Economist* is due to the former including and the latter omitting, in the combined balance sheet, the figures of the Yorkshire Penny Bank and those of the Co-operative Wholesale Society Bank.

So far the changes in the Joint Stock Bank position have been considered between the period 31st December, 1913, and 31st December, 1919. On the next two pages there are given combined balance sheets showing the position at 31st December, 1920, compared with that at 31st December, 1919.

Table A shows the following main changes in liabilities during the twelve months—

1. A satisfactory increase of over £22,000,000 in capital paid-up and reserve funds. Part of the increase in capital represents duplication through bank purchase of the shares of other banks.

2. A reduction of over £48,000,000 in acceptances on behalf of customers. This reduction was due to the slump in trade, which commenced about July, 1920, and the great fall in wholesale commodity prices, which commenced in April, 1920.

3. An increase of about £150,000,000 in the aggregate of credit balances, which the table of assets clearly proves to have been due to further credit expansion.

Table C shows the following main changes in assets during the twelve months—

1. A reduction of £47,000,000 in investments. This decrease was due to reduced holdings of investments and sums written off for depreciation.

2. An increase of £75,000,000 in bills discounted, presumably due to increased holdings of Treasury Bills, for the slump in trade and great fall in wholesale prices during 1920 probably caused some reduction in holdings of trade bills.

3. And an increase of £140,000,000 in advances. This large net increase was due to further expansion in credit during the first six months of 1920. During the last six months of the year advances diminished, but the banks were unable to effect any

COMBINED BALANCE SHEET OF THE BANKS OF THE UNITED KINGDOM (EXCLUSIVE OF THE BANK OF ENGLAND) 1920 AND 1919

(Compiled by "The Statist," and published in its issues dated 21st May, 1921, and 15th May, 1920)

TABLE A. LIABILITIES

	1920	% of Total.	1919	% of Total.	Increase + Decrease –
	£		£		£
Capital paid up	92,844,000	3·2	77,155,000	2·8	+ 15,689,000
Reserve funds .	71,334,000	2·5	64,398,000	2·3	+ 6,936,000
Total .	164,178,000	5·7	141,553,000	5·1	+ 22,625,000
Notes in circulation . . .	54,255,000	1·9	57,413,000	2·1	– 3,158,000
Acceptances . .	112,453,000	3·9	161,095,000	5·8	– 48,642,000
Deposit, Current & other acc'ts.	2,549,288,000	88·2	2,398,831,000	86·7	+150,457,000
Profit balance .	8,917,000	·3	8,159,000	·3	+ 758,000
Total Liabilities	2,889,091,000	100·0	2,767,051,000	100·0	+122,040,000

TABLE B. ASSETS

	1920	% of Total.	1919	% of Total.	Increase + Decrease –
	£		£		£
Cash in hand, at Bank of England, etc . .	440,743,000	15·3	443,538,000	16·0	– 2,795,000
Money at Call and at short notice[1]	153,098,000	5·3	150,594,000	5·5	+ 2,504,000
Investments .	552,671,000	19·1	600,035,000	21·7	– 47,364,000
Bills discounted[1]	415,872,000	14·4	364,722,000[2]	13·2	+ 51,150,000
Advances . .	1,182,816,000	40·9	1,018,476,000[2]	36·8	+164,340,000
Liability of Customers for Acceptances . . .	112,453,000	3·9	161,095,000	5·8	– 48,642,000
Bank premises, etc	31,438,000	1·1	28,591,000	1·0	+ 2,847,000
Total Assets .	2,889,091,000	100·0	2,767,051,000	100·0	+122,040,000

[1] Where shown separately. Bankers do not in all cases separate their cash from their call loans or their bills discounted from their advances. For the two years dealt with, however, the practice of the individual banks (particularly in regard to the separation of cash in hand from money at call and short notice) has only varied in few instances.

[2] These amounts should really be £346,658,000 and £1,036,540,000, *The Statist* in its summarization of balance sheets having inadvertently placed an amount of £18,064,000 in the wrong column.

considerable reduction on account of financial difficulties of customers, who held large stocks of more or less unsaleable high-priced goods, received numerous cancellations of orders from home and abroad, and who felt severe financial strain from non-receipt or delay in receipt of expected inland and foreign remittances. The net increase in advances, notwithstanding the great fall in prices which would normally cause a reduced demand for credit and automatic reduction in bank advances, clearly proves that the banks well supported their customers during the semi-crisis year 1920, and did not attempt to enforce compulsory deflation, except in cases where loans were employed in speculative directions. At all times when there is stickiness in the usual normal flow of credit, there is a tendency for bank advances to increase.

In the following table of Assets it has been assumed that the experience of banks that separate on their balance sheets "Cash in hand and at Bank of England" from "Money at Call and at Short Notice," and "Bills Discounted" from "Advances," the one from the other, is that of all the banks, and the amounts have been apportioned on this basis—

COMBINED BALANCE SHEET OF THE BANKS OF THE UNITED KINGDOM (EXCLUSIVE OF THE BANK OF ENGLAND), 1920 AND 1919

(For Liabilities see Table A on preceding page)

TABLE C. ASSETS

	1920		1919		
		% of Total.		% of Total.	Increase + Decrease −
	£		£		£
Cash in hand, at Bank of England, etc. . .	420,000,000	14·6	423,000,000	15·3	− 3,000,000
Money at Call and at Short Notice.	174,000,000	6·0	171,000,000	6·2	+ 3,000,000
Investments .	553,000,000	19·1	600,000,000	21·7	− 47,000,000
Bills discounted	451,000,000	15·6	376,000,000	13·6	+ 75,000,000
Advances . .	1,147,000,000	39·7	1,007,000,000	36·4	+140,000,000
Liability of customers for acceptances . . .	112,000,000	3·9	161,000,000	5·8	− 49,000,000
Bank premises, &c	32,000,000	1·1	29,000,000	1·0	+ 3,000,000
Total Assets .	2,889,000,000	100·0	2,767,000,000	100·0	+122,000,000

The following table shows the general tendency of the banking position between 1st January–31st May, 1921, the figures summarized for nine Joint Stock Banks representing about 70 per cent. of the total banking resources of the United Kingdom (exclusive of the Bank of England).

NINE ENGLISH JOINT STOCK BANKS

(Million £'s)

	WEEKLY AVERAGES.					
	Dec. 31, 1920.	Jan., 1921.	Feb., 1921.	March, 1921.	April, 1921.	May, 1921.
Paid up capital and reserve	115·0	115·4	115·6	115·6	115·6	115·8
Acceptances	87·9	88·4	77·5	69·4	63·0	63·0
Deposits (including undivided profits) . . .	1804·6	1810·1	1754·4	1715·0	1709·9	1729·3
Total . . .	2007·5	2013·9	1947·5	1900·0	1888·5	1908·1
Cash in hand, at Bank of England, etc.	304·1	256·2	247·4	244·8	249·6	250·3
Money at call and at short notice	113·0	98·9	87·9	82·6	91·9	96·5
Investments	339·1	341·3	340·0	336·1	333·7	331·2
Bills discounted . . .	296·3	361·9	328·9	282·1	275·1	304·0
Loans and advances . .	845·1	845·1	843·5	862·6	852·2	839·9
Liability of customers for acceptances	87·9	88·4	77·5	69·4	63·0	63·0
Bank premises, etc. . .	22·0	22·1	22·3	22·4	23·0	23·2
	2007·5	2013·9	1947·5	1900·0	1888·5	1908·1

From the above table it will be observed that the amount of acceptances continues to diminish, for reasons already stated. There is shown a reduction in bank liabilities on deposit and current accounts, reflecting, in the main, *per contra*, reduction in the cash reserves and in money at call and at short notice, due to causes over which the banks had no control. Investments show a small reduction. Bills discounted show a net increase, but loans and advances a slight decrease. The figures clearly prove that, notwithstanding the reduction in cash resources and in money at call and at short notice, the banks continued to afford considerable support to their customers in a difficult period.

The resumption of the publication of monthly balance sheets by the larger banks commenced in February, 1921, and the figures, it is to be noted, are now based on weekly averages, a recommendation made by the Committee on Currency and Foreign Exchanges after the War, in their interim report published on 29th October, 1918.

(c) SAVINGS BANKS

The table given on the next page shows, at yearly intervals, the liabilities of the Government on Savings Bank Account since the outbreak of the recent war, monthly figures being given for the year 1914 to prove that the outbreak of war had very little effect on Savings Bank deposits. It will be observed from the table that during the first two months of the war Savings Bank deposits showed a tendency to decline, the actual decrease from 11th July to 5th September being about £5,300,000, representing a little over 2 per cent. of the accumulated funds. This decrease cannot altogether be attributed to the outbreak of war, for the holiday months, July and August, are generally bad months for Savings Banks. From October to December the deposits remained about stationary, a slight increase being recorded, but the figures include £729,691 interest credited on 20th November (for the past six months) to the Fund for the Banks for Savings.

At 2nd July, 1921, the amount standing to the credit of the Trustee Savings Banks was £72,533,116, the Post Office Savings Bank £272,217,296, total £344,750,412, or £2,737,396 more than at 31st July, 1920.

The first War Loan, which bears 3½ per cent. interest, and was issued during 17th–24th November, 1914, at £95 per cent., had no discernible effect on Savings Bank deposits, but the appearance of the second loan, which bears 4½ per cent. interest, and was issued during 21st June—10th July, 1915, at par, produced a marked effect on such deposits. Concurrently with the issue of the prospectus, and whilst the application lists remained open, widespread appeals to patriotism were made by extensive Press support and advertisements. Many of the advertisements were powerful direct appeals to women to subscribe to the loan, and thus help their fighting countrymen. The effect of this publicity campaign on Savings Banks was shown by a decrease of about £20,000,000 in

LIABILITIES OF THE GOVERNMENT ON SAVINGS BANK ACCOUNT

At	Total amount at the credit of		Total.	Increase + Decrease −
	The Fund for the Banks for Savings (Trustee Savings Banks)	The Post Office Savings Bank Fund		
				For 1 month.
1914	£	£	£	£
Jan. 24 .	53,595,108	188,781,224	242,376,332	+ 2,571,904
Feb. 21 .	53,758,435	189,396,492	243,154,927	+ 778,595
Mar. 21 .	53,904,592	189,935,779	243,840,371	+ 685,444
April 18 .	53,939,455	190,652,680	244,592,135	+ 751,764
May 16 .	53,799,052	190,748,413	244,547,465	− 44,670
June 13 .	54,549,025	190,791,971	245,340,996	+ 793,531
July 11 .	54,482,781	192,044,322	246,527,103	+ 1,186,107
Aug. 8 .	52,979,463	191,516,822	244,496,285	− 2,030,818
Sept. 5 .	52,786,574	188,389,779	241,176,353	− 3,319,932
Oct. 3 .	52,792,530	188,280,044	241,072,574	− 103,779
Oct. 31 .	52,935,990	189,671,969	242,607,959	+ 1,535,385
Nov. 28 .	53,009,464	190,286,806	243,296,270	+ 688,311
Dec. 26 .	53,344,415	189,387,699	242,732,114	− 564,156
				For 1 year.
Aug. 8, 1914	52,979,463	191,516,822	244,496,285	+ 6,141,243
„ 7, 1915	50,371,832	181,648,755	232,020,587	− 12,475,698
„ 5, 1916	52,232,866	193,953,283	246,186,149	+ 14,165,562
„ 4, 1917	48,716,324	194,811,264	243,527,588	− 2,658,561
„ 3, 1918	56,281,545	220,655,438	276,936,983	+ 33,409,395
„ 2, 1919	68,422,709	261,420,027	329,842,736	+ 52,905,753
July 31, 1920	72,198,384	269,814,632	342,013,016	+ 12,170,280
Increase for 6 years .	19,218,921	78,297,810	97,516,731	

The figures given in the above table do not represent the exact amounts due to depositors of the two classes of savings banks at the respective dates, but are the amounts which have been handed over by the Savings Banks for investment by the National Debt Commissioners, in conformity with the Savings Banks Acts. The Trustee Savings Banks keep a small cash balance with local Joint Stock Banks and the Postmaster-General also keeps a small balance on Savings Bank Account to meet current withdrawals. These cash balances in both cases are, however, usually less than 1 per cent. of the liabilities to depositors, so the fluctuations in the figures shown in the table may, therefore, be taken as representative of the experience of the Savings Banks since the commencement of the war. The figures for the Trustee Savings Banks do not in any way include the funds of the Special Investment Departments of the Trustee Savings Banks, for the funds of such departments are not handed over to the National Debt Commissioners, but are invested direct by the Trustees of the banks, subject to certain statutory restrictions, and largely in temporary Government Loans and in local loans.

the aggregate funds during the four weeks 11th July–7th August, 1915. This decrease represented exactly 8 per cent. of the aggregate

funds at 10th July. By an interesting coincidence the Trustee Savings Banks and the Post Office Savings Bank both suffered a like proportionate decrease, the figures being about £4,200 000 and £15,900,000 respectively. There is every reason to believe that the main influence which made Savings Bank depositors subscribe £20,000,000 to the second War Loan was the widespread appeals to patriotism, and not the high rate of interest borne by the loan. The Postmaster-General, in his report for the year 1915, made the following comment on the effect of the 4½ per cent. War Loan on the deposits of the Post Office Savings Bank: "It is noteworthy that the diversion of large sums of money into War Loans and Exchequer Bonds has had little effect upon deposits in the Post Office Savings Bank. In June and July, 1915, when the lists for the 4½ per cent. loan remained open, withdrawals exceeded the normal by £18,000,000; and in January and February, 1916, when the 5 per cent. Exchequer Bonds were launched, there was some further diversion, but only of comparatively small amounts."

Notwithstanding the outbreak of war and withdrawals for investment in the first two War Loans, Savings Bank funds only decreased by about £12,500,000 during the first year of the war. The following year this decrease was more than made up by an increase of about £14,200,000 for the year.

A further drain on Savings Bank deposits was experienced during the issue of the third War Loan, the prospectus of which appeared on 12th January, 1917. This loan was divided into two parts: a 5 per cent. loan issued at £95 per cent., and a 4 per cent. loan issued at par, with Income Tax compounded. The lists for applications closed on 16th February, 1917. When giving detailed particulars of the stupendous success attending the third War Loan to the House of Commons on 26th February, 1917, the Chancellor of the Exchequer stated that, during the War Loan campaign, special care had been taken not to encourage withdrawals from the Savings Banks, with the result that these withdrawals, in spite of the immense sum raised by the loan, were £6,000,000 less than in the 1915 loan. Notwithstanding withdrawals for investment in the third War Loan, Savings Bank funds only decreased about £2,600,000 during the third year of the war.

During the year ending 3rd August, 1918, there was a substantial increase of about £33,400,000 in Savings Bank funds, which was followed by a still greater increase of about £52,900,000 for the next year, and an increase of about £12,200,000 for the year ending 31st July, 1920. The fourth War Loan (the Victory Loan), which was issued during 13th June–12th July, 1919, had no material influence on Savings Bank deposits. The total increase for the six years ending 31st July, 1920, was about £97,500,000, or an average annual increase of about £16,200,000. For the ten pre-war years 1904–1913, the increase in Savings Bank deposits was about £43,000,000, or an average annual increase of £4,300,000. The great increase experienced during the three years ending 31st July, 1920, was due to two causes, partly to the great increase in wages that took place during this period leaving the working classes with a greater margin for saving purposes, but mainly to the removal, as from 31st December, 1915, of the statutory restrictions on the amount of deposit by any one depositor. At the outbreak of war there were restrictions in operation on the amount of money that might be deposited by any one depositor in the Post Office Savings Bank or a Trustee Savings Bank (Ordinary Department), the limits of deposit being £50 annual and £200 total. The War Loan (Supplemental Provisions) Act, 1915 (5 and 6, Geo. 5, c. 93), provided, among other provisions, for the removal or alteration temporarily by an Order promulgated by the Treasury of the limits of deposit in Savings Banks for a period not longer than that of the duration of the war and six months thereafter. In conformity with this provision, the Treasury made an Order, dated 31st December, 1915, removing for the period of the war and six months thereafter the existing restrictions on the amounts which might be deposited by any one depositor in the Post Office and Trustee Savings Banks. On 20th May, 1920, a Savings Bank Act (10 and 11, Geo. 5, c. 12) was passed which provided that there shall be no limit on the amount which may be received by a Savings Bank authority from any person by way of deposit, but made it lawful for the Treasury at any time to limit the amount which may be received from any person whatsoever, either in any one year or in the aggregate. So far, no restrictive order has been made by the Treasury.

The great increase in the amount of Savings Bank deposits

during the years 1918 and 1919, notwithstanding the high rates of interest borne by the various War Loans and other forms of Government borrowing, proves beyond all doubt—what has often been contended by those experienced in Savings Bank matters—that depositors attach more importance to security and the facilities afforded for deposit and withdrawal (including the issue of a suitable pass-book) than to the rate of interest. Throughout the war, and since, the Savings Bank rate of interest has remained at the old and low rate of 2½ per cent. per annum. On grounds of equity to depositors, the rate might have been temporarily raised to, say, 3 per cent., in view of the much higher rates derived by investment in War Loans, Exchequer Bonds, National War Bonds, War Savings Certificates, and other forms of Government borrowing, and the publicly expressed desire of the Government that no excessive transfers thereto should be made from Savings Bank deposits.

(*d*) The Amalgamation Movement

During the twenty years immediately prior to the war, about 120 separate banks were absorbed by the process of amalgamation. After the outbreak of war, for a period of over three years, there came a lull in the amalgamation movement, the larger banks, evidently in view of the uncertainty of the financial situation, deeming the better policy to husband their own resources for all eventualities.

In 1918, however, there came quite an epidemic of amalgamations, some of which were of a new type. Prior to the war, amalgamations took the form of absorption of more or less local banks by a larger and more widely-spread Joint Stock Bank. At the end of 1917, a new type appeared—the union of one large Joint Stock Bank with another similar bank. In December of that year the amalgamation of the London & South Western Bank (Deposits at 31st December, 1917, £38,664,000) with the London & Provincial Bank (Deposits at 31st December, 1917, £35,962,000) was announced, and also the amalgamation of the Union of London & Smiths Bank (Deposits at 31st December, 1917, £62,818,000) with the National Provincial Bank of England (Deposits at 31st December, 1917, £112,597,000). In February, 1918, two large amalgamations were announced; Parr's Bank (Deposits at 31st December, 1917, £68,631,000) with the London County & Westminster Bank

(Deposits at 31st December, 1917, £142,268,000) was announced on the 1st of the month, and the London Joint Stock Bank (Deposits at 31st December, 1917, £57,979,000) with the London City & Midland Bank (Deposits at 31st December, 1917, £220,552,000) on the 18th of the month. (This latter proposed amalgamation was refused Treasury sanction until July, because it followed the announcement of the Chancellor of the Exchequer on 5th February that he proposed to appoint a Committee to consider the whole question of Bank Amalgamations.) During July, 1918, two further important amalgamations were announced—the London Provincial & South Western Bank[1] (Deposits at 31st December, 1917, £74,626,000) with Barclays Bank (Deposits at 31st December, 1917, £129,068,000), and the Capital and Counties Bank (Deposits at 31st December, 1917, £58,646,000) with Lloyds Bank (Deposits at 31st December, 1917, £174,068,000).

The amalgamation movement of large banks that commenced in December, 1917, arousing fears in the commercial world of the establishment of a money trust, the Chancellor of the Exchequer, to allay these fears, announced in the House of Commons on Tuesday, 5th March, 1918, that a Committee had been appointed "to consider and report to what extent, if at all, amalgamations between banks may affect prejudicially the interests of the industrial and mercantile community, and whether it is desirable that legislation should be introduced to prohibit such amalgamations or to provide safeguards under which they might continue to be permitted." The Committee was composed chiefly of bankers, with, however, a sufficiently strong infusion of ordinary business representatives. All proposed amalgamations were held up whilst the Committee was sitting.

On Tuesday, 21st May, 1918, the Committee presented its Report. Below are given some of the statements of and conclusions come to by the Committee—

Bank absorptions and amalgamations are, of course, no new phenomenon in this country. About 300 instances have occurred in the past, more than half of which have taken place in the last 50 years. In one or two cases arrangements made provisionally for amalgamations have been defeated by the opposition of local customers of the bank which it was proposed to absorb; but, on the whole, banking policy has gradually but steadily pursued the path of consolidation and absorption, and, until recently, the

[1] The London & Provincial and the London & South Western Banks had amalgamated only in the previous December—*see* above.

amalgamations effected have, generally speaking, been carried through without stirring up serious opposition or arousing public interest. As a result, the number of private banks has fallen from 37 to 6 since 1891, and the number of English Joint Stock Banks from 106 to 34 during the same period.

Several recent amalgamations, however, have undoubtedly provoked an unusual amount of interest, and have been seriously criticised in certain quarters. This change in public opinion appears to be due mainly to the fact that amalgamations have changed their type and consist no longer in the absorption of a local bank by a larger and more widely spread Joint Stock Bank, but in the union of two Joint Stock Banks, both already possessing large funds and branches spread over a wide area. These two types of amalgamation differ very materially from one another, and arguments used to justify the former type do not necessarily apply to the latter.

THE OLD TYPE OF AMALGAMATION—ABSORPTION OF LOCAL BANKS BY A LARGER AND MORE WIDELY-SPREAD JOINT STOCK BANK

As modern amalgamations are mainly of the new type, it is unnecessary for us to elaborate the various arguments used in connection with amalgamations of the older type. Very briefly, what the arguments amount to is that both the local (or more or less local) bank and the larger widely-spread bank secure to their customers certain advantages of a different kind, but that, like other institutions, each has also the defects of its qualities. Some districts—notably Lancashire and Yorkshire—have clung to their local banks. But in most instances, amalgamation schemes have been carried out without serious difficulty, and if material hardship had resulted to the trade generally in the districts affected, there would no doubt have been greater local opposition to subsequent absorption schemes, and new local banks would even have been opened.

THE NEW TYPE OF AMALGAMATION—UNION OF ONE LARGE JOINT STOCK BANK WITH ANOTHER SIMILAR BANK

As regards the new type of amalgamation, the main arguments laid before us in support of the policy of amalgamation are as follows—

(a) *The convenience and gain to Trade secured by an extension of Bank areas.*—Just as the large banks of the past secured certain advantages to trade by collecting deposits from parts of the country where they were not required, and placing them at the disposal of other parts which stood in need of advances, so it is claimed that this process can be carried still further with advantage by amalgamating large banks with one another.

This is no doubt true, though, of course, the degree to which an extension of area is in fact secured by amalgamating banks differs considerably in each case.

There must come a point when the policy of substituting one large bank for two will usually mean a very small extension of area, if any, and some reduction of competition. That point has already been reached in London, and is being approached in a few of the largest towns where most of the important competing banks are already established.

It should be added that if both the amalgamating units have, before amalgamation, lent up to their full resources, home trade *as a whole* cannot gain any increase in accommodation as a result of the amalgamation. Except at the expense of smaller traders, large trade combines could not obtain larger advances in all from the combined resources of the amalgamation than they obtained from the separate banks before.

(b) *The argument from size.*—Numerous representations have reached us to the effect that large banks are better for traders, and particularly for large traders, than small banks, because, with their larger resources, they can safely

make individual advances on a more generous scale. And it is argued that banks must grow now to keep pace with the growth in size of business houses generally, and to enable them to deal with the demands of after-the-war trade both at home and abroad.

This is an important point. Various Government Committees have drawn special attention to the question of banking facilities after the war, and it is very desirable that all possible steps should be taken to adapt the banking interest to the new position which will then arise. The point, however, with regard to the size of banks is one of degree only, and it is a question whether the continued practice on the part of exceptionally large firms of resorting to two or more banks, instead of one, for advances would not suffice to meet all their needs, and whether the existing large banks are not, in fact, large enough to meet the requirements of the immediate future, at any rate if supplemented, as far as may be necessary, by combinations for special purposes on the lines of German " Konsortiums " or otherwise. We have received no conclusive evidence on this point.

The above argument with regard to post-war trade can, of course, only be used with some caution as regards foreign trade, in view of the special dependence of English banks on deposits withdrawable at call or on short notice. This is especially the case as regards long-term advances for such trade, to which special reference is sometimes made.

We have endeavoured to review impartially the arguments which have been put forward as justifying the necessity in the public interest—quite apart from questions of profit to shareholders—of bringing about the new type of bank amalgamation. There is undoubtedly much weight in these arguments as far as they go. And even if the absolute *necessity* of large new amalgamations is not clearly proved, yet the absence of proof of the public necessity for business re-organizations is not, in itself, any reason for objecting to them, and it is a serious step at any time to interfere with the natural developments of trade. Before, therefore, considering any restrictive proposals, we endeavoured to ascertain what is the real basis of the fears—often vaguely felt, and vaguely expressed—which have undoubtedly been aroused by recent amalgamation schemes. The main grounds for objecting to further amalgamations appear to be as follows—

(a) *Writing down of Bank Capital.*—The proportion of capital to deposits is now so small in the case of English Joint Stock Banks, even excluding the temporary war increase in the amount of deposits, that any further shrinkage of bank capital is clearly undesirable, in the interest of depositors, if it can be avoided. Attention has been drawn to the fact that amalgamation schemes usually mean a reduction in the total paid-up capital and uncalled liability of the two pre-amalgamation units. This has frequently been the case in the past, and it has also been a feature of recent amalgamations and proposed amalgamations.

(b) *Dangers of reduced Competition.*—Although, in the past, we believe that amalgamations have not, in most instances, led to a reduction of bank competition, yet, as we have pointed out above, in London (and possibly before long in certain large towns) amalgamations between two large Joint Stock Banks must now usually mean a net reduction in the number of competing banks. It is true that this reduction is only slight in each case, and that there still remain at present a fair number of competing banks. But we have received representations from certain municipal corporations to the effect that banks vary very much in their willingness to allow reasonable overdraft facilities to corporations, and that sufficient money, and cheap enough money, has only been obtained hitherto by resorting to different banks, the number of which is now falling steadily. On this ground a number of resolutions have been forwarded to us by corporations protesting against further amalgamations, and suggesting that it is not in the national interest that large funds belonging to the public should be in the hands of a few companies.

Strong representations have, on similar grounds, been made to us on behalf of the Stock Exchange and the Money Market. It is claimed that the world-wide fame of the London Market before the war was due to the freedom with which London bills could be negotiated, owing to the ease with which Discount Houses obtained ample funds from a wide number of banks, and that the fewer the lending constituents in the Discount Market, the less flexible is the market and the less fine the rates. It is added that the number of members in the Clearing House is already becoming very small, and that any further decrease in the number of its constituent members, or any greatly preponderant power on the part of particular members, might impair confidence in its smooth working and raise apprehensions in the market. Moreover, it is pointed out that a reduction in the number of important banks must mean, and has already meant, a reduction in the number of first-class acceptors of bills, and that if this reduction proceeded very far, it would become a question whether the Bank of England would not have to place a limit on the amount of acceptances which they would take from any particular bank doing a large accepting business, and whether Continental buyers would not limit the number of bills taken by them.

(c) *The Danger of Monopoly.*—It has been represented to us that there is a real danger lest one bank, by the gradual extension of its connections, may obtain such a position that it can attract an altogether preponderant amount of banking business; or, alternatively, lest two banks may approach such a position independently, and then achieve it by amalgamation.

Any approach to a banking combine or Money Trust, by this or any other means, would undoubtedly cause great apprehension to all classes of the community and give rise to a demand for nationalizing the banking trade. Such a combine would mean that the financial safety of the country, and the interest of individual depositors and traders, would be placed in the hands of a few individuals, who would naturally operate mainly in the interests of the shareholders. Moreover, the position of the Bank of England—which would, it may be assumed, stand outside any such Trust—would be seriously undermined by so overwhelming a combination, and the Bank might find it extremely difficult to carry out its very important duties as supporter and regulator of the Money Market. Any such result would, in our opinion, be a grave menace to the public interest.

Further, it has been represented to us that the Government of the day might not find it easy to adopt a course of which the combine, for its own reasons, disapproved.

While we believe that there is at present no idea of a Money Trust, it appears to us not altogether impossible that circumstances might produce something approaching to it at a comparatively early date. Experience shows that, in order to preserve an approximate equality of resources and of competitive power, the larger English banks consider it necessary to meet each important amalgamation, sooner or later, by another. If, therefore, the argument from size, referred to above, is to prevail, it can only lead, and fairly rapidly, to the creation of a very few preponderant combinations; and if those combinations amalgamated, or entered into a joint agreement as to rates and policy, etc., the Money Trust would immediately spring to birth.

Such are the main arguments laid before us against further amalgamations. Undoubtedly some of the dangers feared are somewhat problematical and remote, and we should very much have preferred to avoid the necessity for any interference by Government with the administration of banking. But on a careful review of all the above considerations, we are forced to the conclusion that the possible dangers resulting from further large amalgamations are material enough to outweigh the arguments against Government interference, and that, in view of the exceptional extent to which the interests of the whole community depend on banking arrangements, some measure

of Government control is essential. Our conclusions on this point were confirmed by the resolution passed at the recent annual meeting of the Association of Chambers of Commerce, in which it was proposed that steps should be taken to guard against amalgamations, etc., shown to be injurious to commercial interests.

We therefore recommend that legislation be passed requiring that the prior approval of the Government must be obtained before any amalgamations are announced or carried into effect. And, in order that such legislation may not merely have the effect of producing hidden amalgamations instead, we recommend that all proposals for interlocking directorates, or for agreements which in effect would alter the status of a bank as regards its separate entity and control, or for purchase by one bank of the shares of another bank, be also submitted for the prior approval of the Government before they are carried out.

As general principles to be acted upon at present by the Government at its discretion, we would suggest that a scheme for amalgamating or absorbing a small local bank, or any scheme of amalgamation designed to secure important new facilities for the public or a really considerable and material extension of area or sphere of activity for the larger of the two banks affected, should normally be considered favourably, but that if an amalgamation scheme involves an appreciable overlap of area without securing such advantages, or would result in undue predominance on the part of the larger bank, it should be refused. Consideration should also, in our opinion, be given to the question of the clerical labour—usually very large—involved by amalgamations during the war, and to the undesirability of permitting an unusual aggregation of deposits without fully adequate capital and reserves.

It only remains to make a suggestion as to which Government department or departments should be charged with the responsibility of approving or disapproving amalgamation schemes, etc., under our proposal above. On the whole, we think that the approval both of the Treasury and of the Board of Trade should be obtained and that legislation should be passed requiring the two departments to set up a special Statutory Committee to advise them, the members of which should be nominated by the departments from time to time, for such period as may seem desirable, and should consist of one commercial representative and one financial representative, with power to appoint an arbitrator, should they disagree.

Early in June, 1918, the Chancellor of the Exchequer stated that the Government proposed to introduce legislation as soon as possible to carry out the recommendations contained in the Report of the Bank Amalgamation Committee. Meanwhile, to avoid delay, a Committee of two had been set up to advise the departments concerned on the desirability or otherwise of any schemes for amalgamations that may be proposed. On 15th April, 1919, the Chancellor introduced a Bill entitled "A Bill to make provision for controlling the amalgamation of Joint Stock Banks and for purposes connected therewith," the Act to take effect as from the 27th day of March, 1919. The Bill, which was afterwards withdrawn, provided that—

Except with the previous approval of the Treasury and Board of Trade, given on an application made for the purpose under this Act, and subject to compliance with any conditions attached to the approval, it shall not be lawful for any Joint Stock Bank (*a*) to amalgamate with any other bank;

or (*b*) to transfer or sell its business or any part of its business to any other bank, or to acquire the business or any part of the business of, or any interest in, any other bank; and except with such approval as aforesaid and subject to such compliance as aforesaid, it shall not be lawful for any person being a director of a Joint Stock Bank to become a director of any other Joint Stock Bank, provided that nothing hereinbefore mentioned shall make it unlawful for any person to hold any directorship which he holds at the commencement of this Act.

The following is a list of amalgamations that have taken place since 1st August, 1914, and up to 30th April, 1921, the years the various amalgamations were announced or proposed being given in parenthesis—

Former Banks	*Amalgamated as*
Parr's Thomas Barnard & Company (1914)	Parr's Bank, Ltd.
Manchester & Liverpool District Bank of Whitehaven (1916)	Manchester & Liverpool District Banking Company, Ltd.
London County & Westminster Parr's (1918) Nottingham & Nottinghamshire (1918) Beckett & Co. (1920)	London County Westminster & Parr's Bank, Ltd.
London & Provincial London & South Western (1917)	London Provincial & South Western Bank, Ltd.
Barclay & Company United Counties (1916) London Provincial & South Western (1918 Gillett & Company (1919) Tubb & Company (1920)	Barclays Bank, Ltd.
Union Bank of Manchester Halifax & District Permanent (1917) East Morley & Bradford Deposit (1918)	Union Bank of Manchester, Ltd.
London City & Midland London Joint Stock (1918)	London Joint City & Midland Bank, Ltd.
Lloyds Capital & Counties (1918) West Yorkshire (1919) Fox, Fowler & Co. (1921)	Lloyds Bank, Ltd.
National Provincial Bank of England Union of London & Smiths (1917) W. & J. Biggerstaff[1] (1918) Bradford District (1918) Sheffield Banking Company (1919) Coutts & Co. (1919)[2] Northamptonshire Union (1920) Shilson, Coode & Co. (1920) Richards & Co. (1920)	National Provincial & Union Bank of England, Ltd.
Bank of Liverpool Martin's (1918) Palatine (1919) Halifax Commercial (1919) Cocks, Biddulph & Co. (1919)	Bank of Liverpool & Martins, Ltd.

[1] Premises acquired. [2] Affiliated by purchase.

Whenever an amalgamation has been announced, reasons have usually been given at the same time, or later at the shareholders' meeting, in support of the absorption. Three important reasons have been that—

(*a*) As trading interests in recent years have shown a tendency to enlargement, through combination, multiple shops, and other causes, it is essential in the national interest that banks must combine their resources to keep pace with such a movement.

(*b*) The combination of a bank with large liquid resources and deposits collected in residential and agricultural areas with a bank whose operations mainly cover a manufacturing area is bound to be beneficial to both banks and to customers, and tend to increased production by the transfer of liquid capital to those areas in which there is a strong demand for increased loans.

(*c*) The disturbance in the usual pre-war distribution of credit balances by banks' own subscriptions and customers' subscriptions to War Loans, and the considerably increased cost of labour, raw materials, and manufactured goods calling for greater loans from banks operating in trading and manufacturing areas, has compelled some of the smaller banks to entertain favourably proposals for amalgamation with larger banks controlling greater liquid resources.

In a circular sent to shareholders on 13th December, 1918, by the Bradford District Bank announcing the proposed amalgamation of that bank with the National Provincial & Union Bank of England, the directors stated—

Although the directors of this bank have for many years advocated the maintenance of local banks, they recognize that the war has materially altered the economic conditions of the world, and they anticipate that demands will be made for greatly increased banking accommodation now that hostilities have ceased and when general trading is resumed. Your directors are assured that the best traditions of this bank for the liberal treatment of its customers will be fully maintained, and they feel confident that the scheme of amalgamation to which they have provisionally agreed and now recommend will prove to be advantageous to both the shareholders and the customers of the bank.

The reasons given to a meeting of shareholders on 21st October, 1919, by the Chairman of the West Yorkshire Bank for the proposed amalgamation of that bank with Lloyds Bank were as follows—

Before the war the Board were not at all anxious to effect any amalgamation, feeling sure that the bank was strong enough to carry on the business it was doing. But the war has changed the position of everything. It has created an entirely new perspective, and entirely new values. These conditions look as if they were more than temporary, and would have to be reckoned with

for a long time ahead. The most prominent factors are the great increase in the price of all raw materials and the unparalleled rise in wages. These two causes are the reason for a great increase in the capital required to run all businesses, further intensified by the shortening of the hours of labour. This latter factor operates in two directions: it causes an increase in the costs of each business by the reduction of production, and, as a direct consequence of this and to avoid the effect of it, every business man is endeavouring to increase production by putting in new machinery and extending his buildings. The effect of all these causes is like a snowball—it is continually gathering weight. The extension of businesses uses up capital for building and machinery and necessarily more capital for the running of these extensions. All these demands for capital mean that the calls on the banks for assistance must needs be very large, and tend to increase as the country settles down to real work, and to develop its trade, and these circumstances especially prevail in the district in which this bank operates. Your directors therefore, after very careful consideration, came to the conclusion that in the interests alike of shareholders and customers it was their duty to effect an amalgamation with a strong bank and so secure the advantages of its larger resources. It is with every confidence that we submit this amalgamation to you as being the best course to take under the present conditions, and the result of which we feel assured no shareholder or customer will regret.

The following table shows the names of the five Joint Stock Banks (now known as the "Big Five") which had more than £250,000,000 due to depositors on 31st December, 1920. The present size of these banks is largely due to a series of amalgamations and the unprecedented creation of bank credit during the war, mainly on Government account.

NAME OF BANK.	Amount due by Bank on Deposit and Current Accounts, at 31st Dec., 1920.
	£
London Joint City & Midland Bank, Ltd. . .	371,841,968
Lloyds Bank, Ltd.	345,028,984
Barclays Bank, Ltd.	327,788,370
London County Westminster & Parr's Bank, Ltd. .	305,380,814
National Provincial & Union Bank of England, Ltd.	278,335,366

Below the £250,000,000 limit the next largest bank is the Bank of Liverpool & Martins, Ltd., which, on 31st December, 1920, had deposit and current account liabilities of £81,206,768.

The amalgamation movement among home banks has certainly not yet reached finality. One would think that a very advantageous amalgamation could be effected by the existing Lancashire banks combining their resources. Such a combination should be mutually advantageous to the banks and their customers.

In addition to the amalgamations already enumerated, some of the English banks during the last few years have formed affiliations or acquired controlling interest in certain Irish and Scottish banks by purchase or exchange of shares. Intimate mutual arrangements have also been made with a number of foreign and colonial banks, and several new overseas banks have been formed partly or wholly with British banking capital. Three English banks have gone so far as to open branches on the Continent. All these developments point to the international character of British Banking in the future.

Two of the most interesting affiliations among home banks, almost amounting to amalgamation, were the close alliance formed by an exchange of shares between Barclays Bank, the Union Bank of Manchester, and the British Linen Bank, which was announced in November, 1919, and the purchase of the business of Coutts's Bank by the National Provincial and Union Bank of England, announced in December, 1919. The agreements provided that there should be no change in the names of the respective banks. The reason why an actual absorption was not made by Barclays Bank of the Union Bank of Manchester and the British Linen Bank was probably on account of the hostility that has been shown by Lancashire banks' customers in the past whenever amalgamation was proposed with London banks, and the loss of note issue privileges to a Scotch bank when absorbed by a London bank.

(*e*) The British Trade Bank or Corporation

On 22nd September, 1916, an important report was issued of a Committee appointed by the Board of Trade to consider desirable means of meeting the needs of British firms after the war as regards financial facilities for trade, particularly with reference to the financing of large overseas contracts. Some time previously to the appointment of this Committee, of which Lord Faringdon was Chairman, the President of the Board of Trade had expressed a personal opinion in the House of Commons that English banking had not been sufficiently adventurous in the past, and might with advantage be more enterprising in the future. This charge was combated by several leading bankers at ensuing bank annual meetings. The Board of Trade later appointed a Committee of bankers and business men to consider and report on the lines above indicated. The report attracted considerable attention and

some unfavourable criticism. Below are given some extracts from the report, showing the main conclusions agreed upon by the Committee—

In view of statements made by witnesses, it is desirable that we should state clearly our definitions of banking facilities in the British sense, and of what we would call by the wider name of financial facilities. The former are properly limited to those which can be provided without a lock-up such as would impair the liquidity of funds and deposits at all and short notice. For this reason, the usual practice of bankers here is to confine their advances as a rule to a currency not exceeding a few months. By financial facilities we mean, generally speaking, those which would involve a longer currency than this.

A careful study of the evidence above referred to, and our own knowledge of banking arrangements and facilities, lead us to the conclusion that there exists to a considerable extent at the present time in this country the machinery and facilities for the finance alike of home trade and of large overseas contracts, and for carrying through much of the business which has been done by foreign banks. The British banks afford, we believe, liberal accommodation to the home producer. British bankers are not shy in making advances on the strength of their customers' known ability and integrity, and the charges for accommodation are, we believe, often lower than the corresponding charges in foreign countries. Similarly, the Colonial banks and British-foreign banks and banking houses render immense assistance to British trade abroad; and certainly in the Far East, and in many parts of South America, British banking facilities do not fall short of those of any other nation. We find also that in the case of large contract operations British contractors, with the assistance of financial houses, have in the past been ready to provide large amounts of capital and to take considerable risk in connection with the operations which they have undertaken.

Our arrangements, however, are faulty in our not co-ordinating many of the facilities mentioned in the previous paragraph. We recognize also that the British manufacturer may be frequently in want of finance of a kind which a British Joint Stock Bank, with liabilities as above described, could not prudently provide; whereas the German banks in particular seem to have been able to afford special assistance at the inception of undertakings of the most varied description, and to have laid themselves out for stimulating their promotion and for carrying them through to a successful completion. We conclude, therefore, that there is ample room for an institution which, while not interfering unduly with the ordinary business done by the British Joint Stock banks, by Colonial banks, and by British-foreign banks and banking houses, would be able to assist British interests in a manner that is not possible under existing conditions.

Such an institution might in many ways be beneficial to the development of British industry and manufactures. It might, in certain cases, after careful examination, agree to make advances for the extension of existing manufacturing plant, or perhaps for the amalgamation or co-ordination of certain works, so as to reduce the cost of production. It would assist these works to obtain orders abroad, and give them reasonable financial facilities for executing these orders. It should give a preference in matters of finance to orders which are to be executed in this country.

Such an institution could also take a leading part in the inception of transactions and assist in connection with the machinery of overseas business. In the case of German manufacturers, it frequently happens that on the board of the manufacturing company there is a representative of a bank, and there seems little doubt from an examination of the information which is available, that the German banks have exercised an amount of control

over the manufacturing concerns in which they are interested, which would not be possible, even if it were desirable, in the United Kingdom. A large number of our manufacturing undertakings are wealthy concerns, and would not tolerate for one moment interference by bankers in their affairs, and, indeed, would probably resent an inquiry into the nature of their business arrangements. Such manufacturing concerns, however, do require assistance when they transact business overseas.

Foreign banks have, in most of their operations, adopted the course of forming syndicates to undertake any business of considerable magnitude. They have headed such syndicates and they have taken the labouring oar in connection with investigations. The members of the syndicate have generally included other banks, and associated with them have been those who were particularly interested in the class of business proposed to be done. These syndicates are formed after the first superficial enquiry has satisfied the banks that there is apparently a good business to be done. Directly this point is reached, the expenditure in connection with thorough investigation is on account of the syndicate. If the business is ultimately proceeded with, the profits or losses on the wind-up of the business are shared *pro rata* after allowance to the bank for management. Some such procedure should be followed here. It would enable the institution to undertake business of a comprehensive character, and its imprimatur would have value when issues were made to the public.

It is desirable that the institution, without coming under Government control, should receive as much official recognition as possible.

Having assured ourselves that the creation of an institution of the character referred to above would not unduly interfere with existing banks, banking houses, or financial institutions, we recommend the formation of a new bank to fill the gap between the home banks and the Colonial and British-foreign banks and banking houses, and to develop facilities not provided by the present system.

The bank should be called the "British Trade Bank," and should be constituted under Royal Charter. Its features should be as follows—

1. It should have a capital of £10,000,000. The first issue should be from £2,500,000 to £5,000,000, upon which, in the first instance, only a small amount should be paid up, but which should all be called up within a reasonable time. A further issue should be made afterwards, if possible, at a premium.
2. It should not accept deposits at call or short notice.
3. It should only open current accounts for parties who are proposing to make use of the overseas facilities which it would afford.
4. It should have a foreign exchange department, where special facilities might be afforded for dealing with bills in foreign currency.
5. It should open a credit department for the issue of credits to parties at home and abroad.

The pith of the report appeared to be that the Faringdon Committee came to three main conclusions, namely: (1) That it would not be prudent for the present British banks to make advances for periods exceeding a few months, because the major part of their deposits are accepted payable at call or short notice; (2) that the German bank practice of granting credit for longer periods than granted by the British banks, and of taking a direct share in manufacturing undertakings, in many cases from their inception, had been of immense aid to German industry and

manufactures ; and (3) that, therefore, in the national interest it was desirable that a new British bank should be formed, which should not accept deposits at call or short notice, but which should make advances on principles similar to those adopted by the German banks in the conduct of their business.

Conclusion (1) raises some very important reflections. For many years the British banks have prided themselves on the supposed great liquidity of their resources. After the experience of August, 1914, when the short loan fund solidified and investments became unsaleable, two events that had been predicted by financial experts, the question arises : Has the so-called liquidity any practical value apart from the published balance sheets tending to create a feeling of confidence in the minds of depositors intelligent enough to understand a balance sheet ? If all bank depositors before the war had on the same day demanded repayment of their deposits in the form of legal tender, only from 8 to 10 per cent. of the total amount could have been so repaid, this percentage representing the total legal tender reserves of the Joint Stock Banks in hand or at the Bank of England. Obviously, the currency of advances and loans, whether averaging only three months, or twelve months, or two years, would have no bearing on the legal tender liquidity demanded on a day of supposed wholesale withdrawals by depositors. On the other hand, there are four very strong reasons why it is essential that each bank should keep a reasonable proportion of its funds in a liquid form : first, to provide for the currency requirements of customers, which vary from time to time ; second, for settlement of daily differences with other banks, due to cross crediting of customers' cheques ; third, to meet seasonal demands for credit ; and fourth, to meet occasional periods of financial strain felt by customers owing to delay in receipt of home and foreign remittances. Again, any one of the big five banks has it in its power, by reducing the amount of its outstanding loans (or by keeping the amount stationary if the other four are expanding their outstanding amount of loans), to drain away from other banks part of their cash resources. This action arises from the necessary settlement for differences due to cross crediting of customers' cheques and discount operations.

An important point ever to bear in mind, under modern conditions of credit, is that, taking the banks collectively as one unit,

they do not make loans out of deposits, but create deposits by making loans. But individually the banks have perforce to regulate the amount of their loans according to the amount of their liquid resources, mainly in order to be prepared for a drain on such resources due to settlement with other banks of differences arising from cross crediting of customers' drawings.

It is now generally recognized that if any individual bank experiences a continuous drain on its legal tender reserves, other banks must necessarily come to its assistance ; otherwise, if it had to suspend payment on account of insufficient supplies of legal tender, and notwithstanding that it was perfectly solvent, given reasonable time to realize its assets, a run would be precipitated on other banks, and a general crisis ensue.

A point of far greater importance than so-called liquidity is the real character of the advances. The true function of the modern bank is to finance produce and raw materials through the various stages of production and manufacture and transport, from the raw material to the ultimate consumer. The banker may be looked upon as paying on behalf of the producer or manufacturer a large proportion of the wages and other charges that have necessarily to be paid before articles are finally ready for consumption and sold ; and, later, he receives reimbursement, plus customary interest charges, out of the proceeds of sales, the trader taking all risk of any ultimate loss. A banker is also justified in making reasonable advances on works of a productive or transport character in the course of construction, provided he is to be repaid soon after completion ; and also for extension or improvement of existing plant leading to increased productive power, provided the loans are not to be of long standing. Advances of the latter type ought to be repaid out of the first profits derived from the increased production. But a banker's duties do not include making advances on fixed capital account, however well secured such advances might be. It is the function of partners and shareholders in manufacturing concerns and other businesses to provide all necessary fixed capital. As a general principle, it is bad banking to finance an article not eventually entering into consumption, or an unproductive enterprise, and therefore not self-liquidating the relative amount of credit expended in its production or purchase. Every true banker instinctively favours quickly liquidating

transactions. He then retains the power to vary his liquid resources from time to time according to current requirements for cash. For this reason, bills of varying maturities provide an excellent investment for banks in *normal* times for a proportion of their resources.

There does not appear to be any legitimate reason why British banks should decline to entertain applications for advances required for periods exceeding six months and up to two years, provided such advances bear a reasonable proportion to the total resources of the banks and are devoted to approved productive or transport purposes.

Finance and trade are now so interwoven that it is a truism to say that the more the banks finance the development of trade and increase productive power, the greater will be the ultimate rewards to the profession of banking itself.

Present deposits in British banks being individually, though not collectively, withdrawable at call or short notice, some reservation might be printed in all pass-books to the effect that the banks reserve the right of demanding at any time, if authorized by the Treasury, one month's notice before withdrawal from credit balances of any sums exceeding some stated amount in the form of legal tender, as a justifiable protection for times of crises. It must be made obvious to depositors that they cannot collectively have the whole of their deposits always awaiting them in the form of legal tender, and yet be receiving interest. A banker must make advances or investments of some character to earn the interest he pays to depositors. The possibility, though improbability, of sudden and heavy withdrawals by depositors being ever present in the minds of bankers, apart from the suggested reservation as to possible notice before withdrawal being required under certain conditions, there should be stored by the Government large reserves of legal tender notes in various denominations to be supplied to the banks in times of crises. The mere knowledge of the availability of these stocks for times of crises would give confidence not only to bankers, but to the business community in general.

In making comparisons between the German and British banking systems, it has always to be remembered that German trade and the German banking system developed considerably later than British trade and the British banking system, and the later development of the former probably accounts for its greater adaptability to modern requirements. The German system is not faultless, nor

is the British : both have their respective merits for their different periods of development. But the German banking system, with its tentacles stretching into every important trade, particularly those of a developmental character, has much for commendation from a national standpoint. To it has been largely due the extraordinary development of the trade, manufactures, and business of Germany in recent pre-war years.

In order to give a banker's views of the present day responsibilities and functions of banks, there are given the following extracts from an address delivered before the Institute of Bankers, on 8th November, 1916, by a late President, Mr. Pownall—

At the present time the principles upon which the British system of banking is based, and the management of the great English banks, are alike criticized by some persons in authority and by others, because the banks do not indulge in what has been called "adventurous" banking. That is to say, they do not become merchant adventurers, promoters, contractors, participators in financial, commercial, industrial, or other development undertakings.

In England, bankers are not traders ; and it is not part of their business to become partners in any trading enterprises, either home or foreign. In Germany, the financier is the master of the commercial and the trading world. He endeavours to group certain industries into single great combines, and he provides for the permanence of his mastery by the right of representation on the board of the combine. One result is the gradual ousting of small enterprises.

The English banker is not a trader : he is a temporary lender of credit. On the other hand, the so-called German banks (for instance, the Deutsche Bank) are to a great extent controllers and shareholders in industrial concerns, and their solidity depends on the continued prosperity of the special industries with which they are identified.

Development companies skilfully handled may introduce much new and good business in England, and if (like the German banks) they once get a deserved reputation for the soundness of the ventures they introduce, they may with fair readiness place the shares of the companies they initiate on the English market.

If we are to form a company or companies to introduce new foreign business, the company must be able, like the German banks, to find investors to take the shares of the concerns it recommends. For everyone's sake, we ought to recognize the distinction between the banker and the merchant. English internal banking works on exceedingly fine lines, and for it to finance business by means of 6, 12, 18, 24, or even 36 months' bills on firms or companies outside the jurisdiction is not within its scope.

Our banking is a vast system of credit resting on a liability to repay in legal tender. The cardinal fact is that repayment is due on demand or at very short notice.

Adventurous banking, and by that, I understand, the investment either at home or abroad for fairly long periods or for permanent purposes of money which is liable to be repaid at call or at short notice, is not banking.

The foregoing views are, as already stated, the views of a practical English banker. But whatever may have been the character of British banking in the past, the question to be answered is : "Are

there any real reasons why British banks should not henceforth be partly connected with manufacturing interests ?" Banks are dependent on the activity of trade for their profits, and trade is largely dependent on banks for credit. What is more natural than that there should be some amalgamation of mutual interests ? But if additional credit facilities are to be provided, it behoves British traders and manufacturers to wake up to the needs of their foreign customers, and generally to be more enterprising and to give greater attention to improvements and developments.

In any case the fact that the present British and German banking systems differ in the extent and kind of their operations is no reason why a system of companies should not henceforth be formed in England with the express object of supporting and extending the trade and manufactures of Great Britain and the Dominions. Institutions capable of examining new projects and of extending credit where needed would prove valuable from a national standpoint. Very gradually the existing British banks may, in the course of time, embrace some of the new functions in the same way as they have in recent years opened savings bank, foreign exchange, and trustee and executorship departments.

The report of the Faringdon Committee appeared, as already stated, on Friday, 22nd September, 1916. Eight months later, namely, on Tuesday, 15th May, 1917, and arising out of the recommendations contained in the report, there was published as a White Paper the full text of a Royal Charter granted to a new institution to be formed and called the British Trade Corporation, and also of the Deed of Settlement. The main purpose of the Corporation was declared to be "to afford advice and financial assistance to British commercial and industrial undertakings, and generally to further the development of British trade, industry, and commerce." It will be observed that the new institution does not use the word "bank" in its title. This omission was intentional, in order that its sphere of activities might not be confounded with the ordinary operations of the purely British banks. The new institution is, in fact, intended to be an evolutionary offshoot of the present banking system, a number of the larger banks, according to a statement made by the President of the Board of Trade on 17th May, 1917, having subscribed to its capital. By the terms of the Charter, the Corporation has full

powers to carry on business both as bankers and as traders on their own account. The authorized capital is £10,000,000, in shares of £10 each ; and the Corporation might commence business as soon as capital to the amount of £1,000,000 had been subscribed and £250,000 paid up. It is very obvious that, as the operations of the Corporation extend, there will have to be considerable enlargement of capital : £10,000,000 will not go far in foreign operations and contracts. Full powers are conferred upon the Corporation in the matter of underwriting and in taking part in the promotion of new undertakings. Provision is made in the Deed of Settlement for the directors and managers of the Corporation receiving a substantial share of the profits, after shareholders have received certain fixed percentages. This profit-sharing provision and the general trading powers conferred on the Corporation occasioned considerable criticism at the time of the publication of the Charter and the Deed of Settlement, and a hostile discussion was raised in the House of Commons on Thursday, 17th May, 1917. Serious objection, too, was taken to the fact that the Chairman of the Committee became Chairman of the Corporation which the Committee recommended ; while some of his colleagues on the Committee became his colleagues on the Corporation, thus exchanging an honorary for a paid appointment. This was considered to create a very undesirable precedent. So far as the general trading powers are concerned, it is obvious that the new Corporation must have some such powers if it is to take a share-interest in developmental enterprises it is supporting, and in which some kind of proprietary interest must at times be advisable. Lack of some control or representation in the management of developmental work would assuredly make the Corporation unwilling to make advances for long periods during the constructive stage.

In an endeavour to meet the hostile criticism, the Government issued, on Wednesday, 13th June, 1917, a White Paper containing the following statements—

Form of Declaration in Regard to the Charter which the British Trade Corporation is Prepared to Give Under its Seal

The British Trade Corporation hereby declares that it has sought and accepted the Charter on the footing that according to the true intent and meaning of the Charter the following are provisions thereof, namely—

That the fundamental object for which the Charter has been granted is the giving of financial assistance to British traders and manufacturers,

especially in connection with overseas trade, and that the Corporation is under an obligation to give full effect to such object, and will be accessible to the business public for the purpose of consultation and otherwise: that the Corporation is not intended to be, nor will it operate, as a competing contractor, merchant, or trader, and that its enterprises shall be directed to the furtherance of its aforesaid fundamental object: that the powers and privileges given to the Corporation by the Charter are intended to be and are the machinery by which the Corporation will effectuate its said fundamental object, and will be exercised for the purpose, as a means of, and with a view to the carrying out or furtherance of the same, or so as to enable the Corporation to deal with situations arising by reason or in consequence of such carrying out or furtherance, and that nothing in the Charter has the effect of conferring any exclusive privilege on the Corporation as regards access to Government information or of placing it in any preferential position as regards the representation of British trade or finance, or of conferring upon it the right of acting as Agent of the Government except upon appointment in each case, or of excluding the Government from selecting other agents in cases in which they see reason for so doing.

Copy of Extract from Minutes Passed at Board of the Corporation on the 8th June, 1917.

RESOLVED—

That Clause 135 of the Deed of Settlement shall not be acted upon until it shall first have been confirmed by a majority of the votes of shareholders in General Meeting, convened subsequently to the first issue of Capital to the public.

(Clause 135 provides for the directors and managers of the Corporation receiving a substantial share of the profits, after shareholders have received certain fixed percentages.)

The official announcement of a very definite interpretation of the limitations of the Charter helped to meet the intentions of the promoters of the Corporation and at the same time to remove the fears of traders and manufacturers as to competition from the Corporation. As at first drafted, the scheme conveyed in many quarters the unfortunate impression of having been framed more with the view to trading as a principal function than to the financing of existing enterprises and furthering development work, the main objects of the recommendations of the Faringdon Committee.

On Wednesday, 27th June, 1917, there appeared the prospectus of the British Trade Corporation. The capital was stated to be £10,000,000, divided into 1,000,000 shares of £10 each, of which 100,000 had already been subscribed and allotted at par previous to the issue of the prospectus. Subscriptions were invited for the issue of 150,000 further shares of £10 each at par, ranking in all respects *pari passu* with the 100,000 shares already privately issued,

The prospectus contained the following announcement as to the business intentions of the Corporation—

THE BRITISH TRADE CORPORATION has been incorporated by Royal Charter with a view to carrying out the recommendations of the Departmental Committee of the Board of Trade appointed "to consider the best means of meeting the needs of British firms after the War as regards financial facilities for trade."

The Corporation will specially devote its energies to the development of the trade of the British Empire in every part of the world. It will provide financial facilities, the currency of which may extend over a longer period than is covered by the usual advances made by bankers, and it will be prepared to assist in opening up new channels for enterprise where it is demonstrated that financial aid can be afforded without undue commercial risks.

Upon the conclusion of the war it is believed that there will be an extension of the spirit of British enterprise which will only require financial help to enable it to accomplish good work for the Empire.

The Departmental Committee above referred to gave special consideration to foreign business methods and arrived at the conclusion that much of the success achieved was due to close co-ordination of interests. The Corporation will further such co-ordination in the case of British commercial and industrial undertakings, as well as afford financial assistance for the enlargement of works and the extension of plant with a view to effecting economies in the cost of production.

There exists to-day no large British financial institution possessing an industrial department or an organization for study and research into new ideas or inventions, which is specially equipped to examine and nurse new schemes or developments until sufficiently proved and ripe for public investment. The Corporation will make this a special feature of its business, and will aim at becoming a link between British industry and the British investor. It will take a lead in the formation of syndicates to deal with business of promise and importance, and it will associate with itself other banking and financial institutions which care to participate in its operations.

Reviewing all the evidence, it must be admitted that a gap exists in the British financial organization for providing capital for commercial developments. Though it may be a safer specialization for a separate organization to undertake such financing than for the banks, yet there appears to be no valid reason why the leading British banks should not gradually extend their operations to embrace some of the modern developments of the German banking system. It will be a matter for regret if banking conservatism in this country, and the present lack of special organization, should eventually force the formation of a series of special trade banks. The main matters for bank judgment are the purposes for which advances are to be devoted, rather than the currency of the loans, subject to the proviso that advances for periods exceeding three or four months, and up to, say, two years, shall bear a reasonable proportion to the total resources of the lending

bank. It is now a recognized fact that the so-called liquidity of bank resources (other than legal tender in hand) must, under the modern system of credit, inevitably disappear in times of general crisis, just when real liquidity is most needed.

What has been said above and in the foregoing pages is not to be construed as suggesting that the British banks should embark upon what is usually termed "adventurous banking." All that the remarks are intended to imply is that the extended maturity of a loan, say loans that will be liquidated within a period of from six months to two years, should not of itself prevent an application for such a loan being accepted, if the loan is to be devoted to approved productive purposes, and the aggregate of such loans outstanding at any time bears a reasonable proportion to a bank's total resources. The basic principle of sound banking is that loans should lead to increased production and therefore to increase in the continuous flow of commodities, the consumption of which automatically liquidates the credit used in their production and transport to the consumer. Temporary loans that lead to improvement in transport facilities should also have due consideration as coming within the domain of banking. As has been previously pointed out, taking the banks collectively as one unit, loans simply involve pen and ink entries. The limit to the creation of such entries is the amount of legal tender in hand and the capacity of the banks to obtain further supplies to meet increased demands for legal tender that may arise from the additional purchasing power resulting from increase in the aggregate amount of outstanding loans, and also to meet reasonable abnormal demands. No banking system in the world can be expected to meet a collective demand for instant repayment of deposits in legal tender without Government action.

A loan made to a householder for household purposes, or against property, even for three months, is not a legitimate banking transaction. It does not lead to increased production or movement of commodities. The banks have great power in their hands for good or evil from a national standpoint.

Probably the best solution to meet British banking traditions and instincts, and at the same time to permit of loans for longer periods than hitherto customary being made in the future, is for the banks to attract a larger amount of fixed deposits, subject to six or twelve months' notice, by offering higher rates of interest.

The British Trade Corporation and kindred companies formed in the future with similar objects will be crippled in their operations by the fact that the credit they create will pass by disbursement to the Joint Stock Banks, who are the generally accepted custodians and manufacturers of purchasing power. If the Joint Stock Banks, however, create the credit, collectively, after disbursement, they retain the greater part of it.

Since the establishment of the British Trade Corporation, reports of the business conducted during three complete years have been issued. In the first report, for the year ended 31st December, 1918, the directors stated that, owing to the war, the commercial conditions existing during the greater part of the year had not been favourable to the development of the Corporation's activities in connection with the finance of overseas trade. In the report for the year ended 31st December, 1919, the directors stated that during the past year the export trade of the country had revived, and the Corporation had rendered substantial assistance in the finance thereof. The net profits for the year were £88,340, which compared with £71,589 for the previous year. The report for the year ended 31st December, 1920, showed £119,309 net profits for the year, and stated that in consequence of the disturbed state of Transcaucasia the branch at Batoum had been temporarily closed. The latest balance sheet and report of the Corporation indicates that acceptance business, the opening of branches in foreign countries, and the acquirement of shares in foreign banks is going to constitute a large part of the Corporation's activities.

BALANCE SHEET, DECEMBER 31ST, 1920

LIABILITIES	*Amount.* £	ASSETS	*Amount.* £
Ordinary Shares	2,000,000	Cash	254,441
Current, Deposit, and other Accounts	2,478,361	Money at Call and Notice	700,000
Acceptances	2,180,745	British Treasury Bills	250,000
Profit and Loss	141,901	Investments	799,265
		Bills Discounted, Etc.	1,977,445
		Liability of Customers for Acceptances	2,180,745
		Capital in Subsidiary Co.'s	307,380
		Furniture	4,566
		Premises	64,045
		National Bank of Turkey	243,120
		Stamp Duty on unissued Capital	20,000
Total	£6,801,007	Total	£6,801,007

The Corporation has opened branches at Batoum, Belgrade, and Danzig, and the National Bank of Turkey, in which the Corporation has acquired 96,810 shares of £10 each (£2 10s. paid), has opened a branch at Smyrna. During 1919 the Corporation, in conjunction with other banks, formed the South Russia Banking Agency, Limited, of whose capital it holds £10,000.

It is too early to state whether the utility of the British Trade Corporation will come up to the intentions of its promotors.

(f) London Bankers' Clearings

In the following table there is shown the amounts of the Town Clearing, the Metropolitan Clearing, and the Country Cheque Clearing for each year since 1910, from which it will be observed there has been considerable expansion in the figures since 1917.

Year.	Town Clearing. £	Metropolitan Clearing. £	Country Cheque Clearing. £	Total Clearing. £
1910	12,697,679,000	770,872,000	1,190,312,000	14,658,863,000
1911	12,596,071,000	796,386,000	1,221,420,000	14,613,877,000
1912	13,813,447,000	841,264,000	1,307,062,000	15,961,773,000
1913	14,191,275,000	855,648,000	1,389,481,000	16,436,404,000
1914	12,434,322,000	860,262,000	1,370,464,000	14,665,048,000
1915	10,911,090,000	929,064,000	1,567,571,000	13,407,725,000
1916	12,328,568,000	1,074,027,000	1,872,451,000	15,275,046,000
1917	15,699,528,000	1,177,478,000	2,244,190,000	19,121,196,000
1918	17,031,628,000	1,429,611,000	2,736,273,000	21,197,512,000
1919	23,214,685,000	1,813,929,000	3,386,768,000	28,415,382,000
1920	32,852,933,000	2,093,750,000	4,072,220,000	39,018,903,000

The reduction in the total clearing for the years 1914–1916 is to be accounted for by restricted Stock Exchange business and part cessation of customary foreign trade, due to war conditions. The great increases shown in the various clearings since 1917 is, in the main, due to the great rise in commodity prices and, in part, to the issues of various war loans, and issue and renewal of Treasury Bills. The great flood of new industrial issues during the latter part of 1919 and early months of 1920 also had an influence on the totals of bank clearings for these two years.

CHAPTER VI

GOVERNMENT BORROWINGS

A REVIEW OF THE DIFFERENT FORMS OF GOVERNMENT BORROWINGS SINCE THE COMMENCEMENT OF THE WAR

THE different forms of borrowing by the Government since the commencement of the war are reviewed at length in the following pages. They are considered under the following classifications: War Loans, War Savings Certificates, Treasury Bills, War Expenditure Certificates, Exchequer Bonds, National War Bonds, and Borrowing Abroad. From this review it will be observed that the most marked feature of British War Finance during the course of the war was a variety of forms of borrowing coupled with repeated extensions of bank credit when Exchequer receipts from taxation and loans from the public were insufficient to meet Government expenditure. The economic evils incident to undue extensions of bank credit are fully discussed in other chapters.

THE FIRST WAR LOAN

The first War Loan, which bears 3½ per cent. interest, was issued on 17th November, 1914, for the fixed amount of £350,000,000, at £95 per cent., payable by instalments up to 26th April, 1915, or, in full, under discount at the rate of 3 per cent. per annum. It yields over 4 per cent. per annum to a subscriber holding until the date of redemption, 1st March, 1928. The Government, however, reserved the right to redeem the loan after 1st March, 1925, on giving three months' notice. The total Exchequer receipts from the loan were £331,798,408, inclusive of bank subscriptions, which amounted to over one-quarter of the total amount. Part of the success of the loan was due to an undertaking by the Bank of England that for a period of three years it would advance on the loan to the holder at any time, without margin, the full value expressed by the issue price at 1 per cent. under Bank Rate varying.

It may here be noted that throughout the war the banks passed their "subscriptions" of grants of credit to the Government, and subscriptions of customers from credit balances, by instalments

through the Public Accounts at the Bank of England, their own balances at the Bank of England being debited and the Public Accounts credited, the transactions being reversed after Government disbursements and the return of payment warrants (after being credited to customers of Joint Stock Banks to whom the Government was indebted for goods or services). This roundabout process of successive transfers, at times, involved heavy displacements of credit.

The following are extracts from the Prospectus issued in connection with the first War Loan—

WAR LOAN,

1925-1928.

ISSUE OF £350,000,000

(Of which £100,000,000 has already been placed in the terms of this Prospectus),

IN STOCK OR BONDS,

bearing Interest at 3½ per cent. per annum, payable half-yearly on 1st March and 1st September.

Price of Issue fixed by H.M. Treasury at £95 per cent.

Dividends representing Interest accrued after the 7th December, 1914, on the various Instalments as they severally fall due will be paid as follows—

On the 1st March, 1915, 4s. 6d. per cent.

On the 1st September, 1915, £1 10s. 11d. per cent.

Applications, which must be accompanied by a deposit of £2 per cent., will be received at the Bank of England, Threadneedle Street, London, E.C., and may be forwarded either direct or through the medium of any Banker or Stockbroker in the United Kingdom. Applications must be for even hundreds of pounds.

Further payments will be required as follows—

£3 per cent. on Monday, the 7th December, 1914.
£10 per cent. on Monday the 21st December, 1914.
£10 per cent. on Thursday, the 7th January, 1915.
£10 per cent. on Thursday the 21st January, 1915.
£10 per cent. on Thursday, the 4th February, 1915.
£10 per cent. on Monday, the 22nd February, 1915.
£10 per cent. on Thursday, the 11th March, 1915.
£10 per cent. on Thursday, the 25th March, 1915.
£10 per cent. on Monday, the 12th April, 1915.
£10 per cent. on Monday, the 26th April, 1915.

The Governor and Company of the Bank of England are authorized to receive applications for this Loan, which will take the form either of Inscribed Stock, or Bonds to Bearer, at the option of the Subscribers.

If not previously redeemed, the Loan will be repaid at par on the 1st March, 1928, but His Majesty's Government reserve to themselves the right to

redeem the Loan at par at any time on or after the 1st March, 1925, on giving not less than three calendar months' notice in the *London Gazette*.

The instalments may be paid in full on or after the 7th December, 1914, under discount at the rate of 3 per cent. per annum.

Scrip Certificates to Bearer, with Coupon attached for the dividend payable on the 1st March, 1915, will be issued in exchange for the provisional receipts. As soon as these Scrip Certificates to Bearer have been paid in full they can be inscribed (i.e. can be converted into Stock); or they can be exchanged for Bonds to Bearer (as soon as these can be prepared) in denominations of £100, £200, £500, and £1,000. Inscribed Stock will be transferable in any sums which are multiples of a penny.

The List of Applications will be Closed on or before Tuesday, the 24th November, 1914.

BANK OF ENGLAND, LONDON, 17*th November*, 1914.

If the loan had been a 4 per cent. one, issued at par, public subscriptions would undoubtedly have been greater than they were. The terms of issue—3½ per cent., issue price £95—were a miscalculation. The loan at its issue price only yields about £3 13s. 9d. per cent., although it will eventually cost the Government fully £4 per cent., when the cash bonus of £5 at redemption is taken into consideration. To meet the increased cost of living under war conditions, investors naturally prefer a loan yielding an immediate 4 per cent. to one eventually yielding 4 per cent., but a lower rate for the present. It is a well-proved fact that market prices of stocks do not reflect the promise of future cash bonuses until a few years before date of redemption.

THE SECOND WAR LOAN

The second War Loan, which bears 4½ per cent. interest, was issued on 21st June, 1915, nominally at par; but, owing to the acceleration of the first payment of interest, really at £98 16s. per cent. The date of redemption of the loan, at par, is 1st December, 1945; but the Government wisely reserved the right to redeem the loan at any time on, or after, 1st December, 1925, on giving three calendar months' notice. As in the case of the first loan, subscriptions were made payable by instalments, but might be paid in full on or after 20th July, 1915, under discount at the rate of 4½ per cent. per annum. Concurrently with the issue of the prospectus, and whilst the application list remained open, widespread appeals to patriotism were made by extensive Press support and advertisements. Many of the advertisements were powerful direct appeals to women to subscribe to the loan, and

thus help their fighting countrymen. The popularizing of the loan through the Press was a wise policy. The total Exchequer receipts from the loan were £592,479,544, inclusive of bank subscriptions, which amounted to nearly a third of the total amount. No fixed amount to the loan was stated by the prospectus.

The leading features of the prospectus issued in connection with the loan are shown below—

£4 10s. % WAR LOAN,

1925-1945.

ISSUE OF STOCK OR BONDS

Bearing Interest at 4½ per cent. per annum, payable half-yearly on the 1st June and the 1st December.

Price of Issue fixed by H.M. Treasury at £100 per cent.

A Full Half-year's Dividend will be paid on the 1st December, 1915.

Applications, which must be accompanied by a deposit of £5 per cent., will be received at the Bank of England, Threadneedle Street, London, E.C., and may be forwarded either direct or through the medium of any banker or stockbroker in the United Kingdom. Applications must be for even hundreds of pounds.

Further payments will be required as follows—

£10 per cent. on Tuesday, the 20th July.
£15 per cent. on Tuesday, the 3rd August.
£15 per cent. on Tuesday, the 17th August.
£15 per cent. on Tuesday, the 31st August.
£10 per cent. on Tuesday, the 14th September.
£10 per cent. on Tuesday, the 28th September.
£10 per cent. on Tuesday, the 12th October.
£10 per cent. on Tuesday, the 26th October.

The Governor and Company of the Bank of England are authorized to receive applications for this Loan, which will take the form either of Inscribed Stock, or Bonds to Bearer, at the option of the Subscribers.

If not previously redeemed the Loan will be repaid at par on the 1st December, 1945, but His Majesty's Government reserve to themselves the right to redeem the Loan at par at any time on, or after, the 1st December, 1925, on giving three calendar months' notice in the *London Gazette*.

The instalments may be paid in full on or after the 20th July, 1915, under discount at the rate of 4½ per cent. per annum.

Scrip Certificates to Bearer, with Coupon attached for the dividend payable on the 1st December, 1915, will be issued in exchange for the provisional receipts. As soon as these Scrip Certificates have been paid in full they can be inscribed (i.e. can be converted into Stock); or, they can be exchanged for Bonds to Bearer (as soon as these can be prepared) in denominations of £100, £200, £500, £1,000, £5,000, and £10,000. Inscribed Stock will be transferable in any sums which are multiples of a penny.

In the event of future issues (other than issues made abroad or issues of Exchequer Bonds, Treasury Bills, or similar short-dated Securities) being made by His Majesty's Government for the purpose of carrying on the war, Stock and Bonds of this issue will be accepted at par, plus accrued interest, as the equivalent of cash for the purpose of subscriptions to such issues.

CONVERSION OF

£3 10s. per Cent. War Loan, 1925-1928	£2 15s. per Cent. Annuities
£2 10s. per Cent. Consols	£2 10s. per Cent. Annuities

Holders of £4 10s. per cent. War Loan, 1925–1945, will have the additional right, in respect of each £100 Stock (or Bonds) held by them, and fully paid in cash, to exercise one or other of the four following options of conversion, provided application for conversion is made not later than the 30th October, 1915.

OPTION 1. *Conversion of £3 10s. per Cent. War Loan,* 1925–1928.—To exchange Stock (or Bonds) of £3 10s. per Cent. War Loan, 1925–28, to an amount not exceeding £100 nominal, for fully-paid Stock (or Bonds) of £4 10s. per Cent. War Loan, 1925–1945, at the rate of £100 of the former, with a cash payment of £5 per cent. thereon, for £100 of the latter.

OPTION 2. *Conversion of £2 10s. per Cent. Consols.*—To exchange Stock (or Stock Certificates) of £2 10s. per Cent. Consols, to an amount not exceeding £75 nominal, for fully-paid Stock (or Bonds) of £4 10s. per Cent. War Loan, 1925–1945, at the rate of £75 of the former for £50 of the latter.

OPTION 3. *Conversion of £2 15s. per Cent. Annuities.*—To exchange Stock (or Stock Certificates) of £2 15s. per Cent. Annuities, to an amount not exceeding £67 nominal, for fully-paid Stock (or Bonds) of £4 10s. per Cent. War Loan, 1925–1945, at the rate of £67 of the former for £50 of the latter.

OPTION 4. *Conversion of £2 10s. per Cent. Annuities.*—To exchange Stock (or Stock Certificates) of £2 10s. per Cent. Annuities, to an amount not exceeding £78 nominal, for fully-paid Stock (or Bonds) of £4 10s. per Cent. War Loan, 1925–1945, at the rate of £78 of the former for £50 of the latter.

The List of Applications will be closed on or before Saturday, the 10th July, 1915.

BANK OF ENGLAND, LONDON, 21*st June*, 1915.

Subscribers to the loan obviously obtained many special privileges. The definite promise that in the event of future issues (other than issues made abroad or issues of Exchequer Bonds, Treasury Bills, or similar short-dated securities) being made by the Government, for the purpose of carrying on the war, stock and bonds of the 4½ per cent. loan would be accepted at par, plus accrued interest, as the equivalent of cash for the purpose of subscriptions to such issues was a very equitable provision, for it was only fair that subscribers to early War Loans should receive the same rate of interest as subscribers to later War Loans. Without such a promise, many investors would wait before subscribing until such time as, in their opinion, the interest on Government War Loans had reached the highest rate likely to be offered. For the next eighteen months, however, the provision proved to be of little value to

subscribers, for during this period the Chancellor of the Exchequer managed to borrow all he needed by the issue of Bonds, Bills, and Certificates. The conversion options obtained by subscribers to the loan were availed of to a considerable extent. The Chancellor of the Exchequer stated on 17th November, 1915, that the amount of 3½ per Cent. Loan converted into the 4½ per Cent. Loan had been £135,000,000 out of the outstanding amount £350,000,000. Many people, however, preferred to continue to hold the 3½ per cent. War Loan on account of its short-dated maturity and the special borrowing privileges attached to it.

The second option, namely, "to exchange stock (or stock certificates) of 2½ per cent. Consols to an amount not exceeding £75 nominal, for fully-paid stock (or bonds) of 4½ per Cent. War Loan (1925–1945), at the rate of £75 of the former for £50 of the latter," was undoubtedly in favour of the Government in the long run. At a price of 66⅔, Consols yield 3¾ per cent. ; and as they are only redeemable at par at the option of the Government from 1923, they obviously, if bought at 66⅔, represent an investment yielding 3¾ per cent. and continuing practically for all time without any fear of conversion to lower rates. Holders of Consols who converted into the 4½ per Cent. Loan will only be assured of 4½ per cent. until 1925. At the time of writing, interest rates are high, but judging from the experience of the past, a time will assuredly come again when the interest rate on Government Stocks will be less than 3¾ per cent. The Chancellor of the Exchequer stated on 15th May, 1916, that the amount of Consols converted into 4½ per Cent. War Loan had been £255,200,000, leaving £280,500,000 Consols outstanding on 31st March, 1916.

Provision was made in connection with the 4½ per Cent. War Loan for subscriptions of sums less than £100 in multiples of £5 through the Post Office. There were also issued scrip vouchers for 5s., 10s., and £1, to encourage the small investor, but the aggregate of these very small subscriptions was not large. The Chancellor of the Exchequer stated on 20th January, 1916, that the number of small vouchers sold had been : 5s., 1,501,000 ; 10s., 421,000 ; £1, 827,000—and their total value, £1,413,000. The number of £5 scrip certificates sold was 798,220, and their value £3,991,100. Other subscriptions through the Post Office amounted to £30,642,000 and through the Trustee Savings Banks to £3,840,000.

In the House of Commons on 22nd November, 1915, the Chancellor of the Exchequer expressed disappointment at the smallness of the amount collected by scrip vouchers and scrip certificates of small denominations, particularly so in view of the large amount being paid in weekly wages. But those who have had any experience of the collection of small deposits from the public knew the scheme would be a failure. The working classes may be divided into two broad divisions: those who have not savings bank accounts, and those who have savings bank accounts. Unless the working man in receipt of a greater income during the war was a saver before the war, there was little probability of his starting to save during war time. It has to be borne in mind that a missionary campaign to persuade non-savers to save must take years to effect any material result. Moreover, a great part of the working classes are not in a state of mind to save unless and until they see the well-to-do stinting themselves. Again, much of the extra expenditure of the working classes has gone in foodstuffs; and in the case of the poorer classes who were habitually underfed, any considerable amount of savings could hardly be expected. The reason why the working classes, who have already learnt the habit of saving, and who have, in most cases, savings bank accounts, have shown a disinclination to invest small sums in War Loans, are as follows—

1. They have in the past become accustomed to the pass-book system and the recognized savings banks. They like to see their savings shown in a pass-book, which they may add to or take from as they may desire.

2. They are prepared to accept a low rate of interest, provided they have reasonable facilities for deposit and withdrawal, and absolute security.

3. They do not like to lock up their money for long periods; in any case, the major part of it.

4. They do not like nor understand stock or bonds of a fluctuating capital value. They have no place at home to keep bearer bonds.

If, instead of issuing vouchers and scrip certificates for small amounts, the Government had stated that the Savings Banks and Joint Stock Banks were prepared to issue special War Loan pass-books, and to receive sums of 1s. upwards, repayable at any time six months after the declaration of peace, or for periods of one year

and multiples of one year—period to be fixed by depositor at time of deposit, interest to be at the rate of 4½ per cent. or any other higher current rate—subscriptions of small sums on War Loan account would have been greater than they have been. Under such a scheme, it might also have been provided that any depositor desiring to make a withdrawal, before the expiration of the period for which the deposit was fixed, might at any time do so ; but the rate of interest on the amount withdrawn would be adjusted to 2½ per cent.—the customary savings bank rate—for the twelve months prior to withdrawal. Alternatively, a scheme might have been arranged whereby a depositor received 3 per cent. interest on his minimum monthly balance, 4 per cent. on his minimum yearly balance, and 5 per cent. on his minimum balance for two or more years. One great truth always to be borne in mind by those arranging for the collection of small subscriptions on War Loan account is that no great volume of money can ever be collected in small sums. In pre-war times only about 5 per cent. of the amount at any time due to depositors in the Post Office and Trustee Savings Banks represented the aggregate of balances under £10, and about 10 per cent. the aggregate of balances under £20.

In connection with the foregoing remarks as to the preference of the small investor for a pass-book, and freedom of deposit and withdrawal, it is to be noted that the greater part of the amount received from sales of War Savings Certificates (reviewed later in the chapter) was received from sales of such certificates in the larger denominations, indicating that their non-liability to Income Tax made them very attractive to people liable to this tax.

THE THIRD WAR LOAN

The chief internal financial event of the third year of war was undoubtedly the issue in January, 1917, of the long-promised new War Loan, and the record amount of the subscriptions thereto. This loan was designed to pay off a large amount of floating debt, and also to raise new money for the war. The first definite indication that the new loan was imminent came on Monday, 1st January, 1917, in the cessation of sales by the Government of Exchequer Bonds and War Expenditure Certificates. Three days later, namely, on Thursday, 4th January, the Government announced

that no further sales of Treasury Bills would be made at present. On Saturday, 6th January, an official announcement was made of the date of issue of the new loan. On Thursday, 11th January, at a mass meeting held at the Guildhall, the Chancellor of the Exchequer announced the terms of the new loan, the actual prospectus being issued the following day. The main features of the loan are shown in the following extracts from the prospectus, from which it will be observed that the chief feature was that it consisted of two separate issues: one bearing 5 per cent. per annum interest, subject to Income Tax, and issued at £95 per cent.; the other bearing 4 per cent. per annum interest, free of Income Tax, and issued at par—

ISSUE OF

£5 % WAR LOAN,

1929-1947.

IN STOCK OR BONDS.

Interest payable 1st June and 1st Dec.

First Dividend as follows, payable 1st June, 1917, on
"Fully-paid Allotments," £1 8 9%
"Instalment Allotments," £0 11 10%

Price of Issue £95 per cent.

Payable as follows—

1. For FULLY-PAID ALLOTMENTS:

On Application	£95%

2. For INSTALMENT ALLOTMENTS:

On Application	£5%
" Friday, 2nd March, 1917	£15%
" Friday, 23rd March, 1917	£15%
" Wednesday, 18th April, 1917	£20%
" Wednesday, 9th May, 1917	£20%
" Wednesday, 30th May, 1917	£20%
	£95%

ISSUE OF

£4 % WAR LOAN,

1929-1942.

("Income Tax compounded.")

IN STOCK OR BONDS.

Interest payable 15th April and 15th Oct.

First Dividend as follows, payable 15th April, 1917, on
"Fully-paid Allotments," £0 12 8%
(The first Dividend on Instalment Allotments will be the full half-year's Interest payable 15th October, 1917.)

Price of Issue £100 per cent.

Payable as follows—

1. For FULLY-PAID ALLOTMENTS:

On Application	£100%

2. For INSTALMENT ALLOTMENTS:

On Application	£5%
" Friday, 2nd March, 1917	£15%
" Friday, 23rd March, 1917	£20%
" Wednesday, 18th April, 1917	£20%
" Wednesday, 9th May, 1917	£20%
" Wednesday, 30th May, 1917	£20%
	£100%

The Governor and Company of the Bank of England are authorized to receive applications for the above Loans, which will take the form of Stock or Bonds to Bearer at the option of Subscribers; Stock may be inscribed as transferable in the Stock Transfer Books, or may be registered as transferable by deed.

Applications, which may be for either Loan, must be for sums which are multiples of £50, and may be for either

(1) "Fully Paid Allotments," or (2) "Instalment Allotments."

They will be received at the Bank of England Loans Office, 5 and 6 Lombard Street, London, E.C.; and may be forwarded either direct or through the medium of any Banker or Stockbroker in the United Kingdom.

British Government Treasury Bills will be accepted under discount at 5 per cent. per annum, and War Expenditure Certificates will be accepted under discount at 5½ per cent. per annum, in both cases as from the 16th February, 1917, in lieu of cash, in payment for " Fully-paid Allotments," provided that the entire proceeds of the Bills and Certificates are so applied.

If not previously redeemed, the Loans will be repaid at par as follows—

£5 per Cent. War Loan, 1929–1947, on the 1st June, 1947.

£4 per Cent. War Loan 1929–1942, on the 15th October, 1942.

But His Majesty's Government reserve to themselves the right to redeem the Loans, or either of them, at par at any time on or after the undermentioned dates, on giving three calendar months' notice in the *London Gazette*—

£5 per Cent. War Loan, 1929–1947, at any time on or after the 1st June, 1929.

£4 per Cent. War Loan, 1929–1942, at any time on or after the 15th October, 1929.

As soon as the necessary statutory authority has been obtained, arrangements will be made for the acceptance by the Commissioners of Inland Revenue of Stock and Bonds of these Loans at their respective issue prices, with due allowance for any unpaid interest accrued thereon, in satisfaction of amounts due on account of death duties, provided such Stock and Bonds have formed part of the estate of the deceased for a period of not less than six months immediately preceding the date of death.[1]

For the purpose of providing against depreciation in the market prices of the Loans, the Treasury undertake to set aside monthly a sum equal to one-eighth of 1 per cent. of the amount of each Loan to form a fund to be used for purchasing Stock or Bonds of either Loan for cancellation whenever the market price falls below the issue price. Whenever the unexpended balance of such fund reaches £10,000,000, the monthly payments for the time being will be suspended, but they will be resumed as soon as the unexpended balance falls below £10,000,000.

Stock will be transferable in any sums which are multiples of a penny. Bonds to Bearer will be issued in denominations of £50, £100, £200, £500, £1,000, and £5,000.

CONVERSION OF

£4 10s. per Cent. War Loan, 1925-1945

£5 per Cent. Exchequer Bonds, due 5th October, 1919 and 1921.

£5 per Cent. Exchequer Bonds, due 1st December, 1920

£6 per Cent. Exchequer Bonds, due 16th February, 1920.

Holders of the above issues, in fulfilment of the options granted in the several Prospectuses relating thereto, may convert their holdings, in whole or in part, as on the 16th February, 1917, and receive in lieu thereof £5 per Cent. War Loan, 1929–1947, and or £4 per Cent. War Loan, 1929–1942, at the rate of

£105 5s. 3d. £5 per Cent. War Loan, 1929–1947, for each £100 converted;

or

£100 0s. 0d. £4 per Cent. War Loan, 1929–1942, for each £100 converted.

Holdings of these issues do not carry any rights of conversion into any future issues that may be made by His Majesty's Government.

The Lists for both Cash and Conversion Applications will be closed on Friday, the 16th February, 1917.

BANK OF ENGLAND, 11*th January*, 1917.

[1] On 17th January, 1917, the Treasury announced that this condition would be waived in favour of holdings of the new Loan (whether acquired by cash subscription or by conversion) which had formed part of the estate of the deceased continuously up to the date of death from the date of the original subscription or application for conversion.

The lists were open for five weeks, yet the prospectus offered no inducement in the shape of discount to intending applicants, who desired to pay up in full, to subscribe much before the last day fixed for the receipt of applications, namely, 16th February, for the amounts of the first interest payments proved that interest only commenced to run from 16th February. This omission occasioned some comment, as tending to retard early fully-paid applications and to cause a great rush during the last few days of the issue of the loan. But the Treasury on 17th January made the following announcement—

"In order that early applicants for the loan may not suffer loss in interest for the whole period during which the subscription list remains open, a special interest payment will be made at the following rates in respect of all applications which are paid for in cash, and not by the discounting of Treasury Bills or War Expenditure Certificates, and are lodged at any bank in the United Kingdom before the close of January—

To applicants for "Fully-paid Allotments" . . .	3s. 4d. per cent.[1]
To applicants for "Instalment Allotments" of £500 and upwards	2d. per cent.[1]

Warrants for this payment will be issued by the Bank of England with the allotment notices."

The effect of the above offer was to accelerate the receipt of applications for fully-paid stocks and bonds, and to cause a special inrush of applications during the last few days of January.

In the case of subscriptions on the instalment principle, the propectus stated that the instalments might be paid in full on or after 2nd March, 1917, under discount at the rate of 4 per cent. per annum, discount in cases where payment was made between two instalment dates to be calculated from the instalment date next succeeding the date of such full payment.

Two novel features of the terms of issue, as shown by the extracts from the prospectus, were the provision of a sinking fund and the acceptance in future of the stock and bonds in payment for Death Duties. The object of these two provisions was obviously to exert a steadying influence on the future market price of the loans. The acceptance of the stock and bonds at their issue price

[1] On the amount applied for.

in payment for Death Duties must materially lessen any volume of forced selling of the 5 per Cent. and 4 per Cent. Loans in connection with the realization of deceased estates. Judging by the rapid appreciation in Government credit after the close of the Napoleonic Wars, it appears to be very probable that the Government will be able to convert both the 5 per Cent. and 4 per Cent. Loans to lower rates of interest on 1st June, 1929, and 15th October, 1929, the respective dates from which the Government has reserved the right to redeem the loans. The then outstanding amount of the loans will not, of course, be actually paid off in 1929, but holders will be invited to exchange their holdings for stock or bonds bearing a lower rate of interest, objectors being paid off in cash, raised, if necessary, by sales of the new issue in 1929. *In connection with the future, it is worth remembering that Government credit at all times is largely governed by the excess of production over consumption by the community. As the excess increases, the rate of interest on gilt-edged securities tends to fall; as the excess diminishes, the rate of interest tends to rise.*

In the matter of the true interest yield from the 5 per Cent. Loan, there has been considerable discussion and some difference of opinion. Owing to the loan being issued at a discount, the yield can be considered from three different standpoints, as shown below—

1. The actual half-yearly interest payments are equivalent to £2 12s. 7½d. per cent. on the issue price, or a yearly rate of £5 5s. 3d. per cent. payable half-yearly. If the half-yearly interest payment due 1st June in each year be invested on that date until 1st December, the date of the second half-yearly interest payment, at the rate of £5 5s. 3d. per cent. per annum, payable half-yearly, the total yield per annum would be £5 6s. 7½d. per cent., plus a payment of £5 at date of redemption or conversion.

2. If the prediction of the loans being converted in 1929 be fulfilled, and the cash payment of £5 due at the date of redemption be considered as discounted over the period 16th February, 1917–1st June, 1929, the true half-yearly yield on the issue price of the 5 per Cent. Loan during the period 16th February, 1917–1st June, 1929, will be £2 15s. 8d. per cent., or a yearly rate of £5 11s. 4d. per cent., payable half-yearly. If the half-yearly interest payment due 1st June in each year be invested on that date until 1st December,

the date of the second half-yearly interest payment, at the rate of £5 11s. 4d. per cent. per annum, payable half-yearly, the total yield per annum would be £5 12s. 10½d. per cent.

3. Should the 5 per Cent. Loan be not redeemed or converted until 1947, and the cash payment of £5 due at the date of redemption be considered as discounted over the period 16th February, 1917–1st June, 1947, the true half-yearly yield on the issue price of the 5 per Cent. Loan during the period 16th February, 1917–1st June, 1947, will be £2 13s. 4d. per cent., or a yearly rate of £5 6s. 8d. per cent., payable half-yearly. If the half-yearly interest payment due 1st June in each year be invested on that date until 1st December, the date of the second half-yearly interest payment, at the rate of £5 6s. 8d. per cent. per annum, payable half-yearly, the total yield per annum would be £5 8s. 1½d. per cent.

From the time of the Chancellor of the Exchequer announcing at the Guildhall the terms of issue of the new loan and up to the closing of the lists on 16th February, 1917, a widespread campaign to popularize the loan was undertaken by the Government, loyally and unanimously supported by the Press, the banks, and the stockbrokers. The banks and stockbrokers sent out to their customers a copy of the prospectus, accompanied by a strong letter-appeal from the Chancellor of the Exchequer. The banks publicly advertised that they were prepared to grant loans not only to existing customers but to strangers to enable them to subscribe to the War Loan, provided the applicants were in a position to pay off the advances within a reasonable time—the expression " reasonable time " generally being understood to mean periods ranging from six months to two years, according to the individual circumstances of the applicants. The object of this offer, which, it is to be noted, was made after consultation with the Chancellor of the Exchequer, was twofold ; first, to endeavour to lead to reduced consumption of goods and services through the individual mortgaging for a period part of his future income ; secondly, to obviate, if possible, the banks themselves being called upon to subscribe on a large scale to the loan. To the 3½ per Cent. Loan issued in November, 1914, the banks, on request by the Government, subscribed about £100,000,000, and to the 4½ per Cent. Loan issued in June, 1915, about £200,000,000. It is shown in the chapter dealing with the banking position during the war,

that bank subscriptions to War Loans cause an expansion in the aggregate of the credit balances due to their customers, for when banks subscribe to War Loans, taking the banks collectively, they in net effect contract with the Government, in return for a certain rate or rates of interest, to credit the amount of their subscriptions to customers to whom payments are due from the Government for goods and services. This the banks are able to do because they are the generally accepted custodians of credit. The policy of financing the necessities of war by a great extension of bank credit is dangerous, because it inevitably leads to inflation of prices of commodities, by reason of an increase in the purchasing power of the community, and eventually gives rise to growing discontent among the masses.

The rate of interest which the banks agreed to charge the public for temporary advances devoted to applications for the War Loan is generally understood to have been 1 per cent. under Bank Rate, with a minimum of 5 per cent.

The public had every facility presented to them for making applications for the War Loan, for, as the prospectus stated, subscriptions were made receivable in multiples of £50, through the medium of any bank or stockbroker in the United Kingdom. At the Post Offices, arrangements were made for receipt of subscriptions under £50 in multiples of £5. To meet the convenience of people who were, for various reasons, unable to attend during ordinary business hours, some of the banks opened their offices in the evenings for receipt of applications, and to afford information relating to the loan and conversions. It is very gratifying to record that one provincial bank (West Yorkshire) illuminated its various offices at night with a large notice reading: "You may apply for War Loan here — daily, 10 to 3; Thursdays, 9 to 12; Saturdays, 10 to 3. EVENINGS, 6 to 8." With such a spirit permeating financial institutions, the success of the loan was assured.

The first official intimation of the great success of the loan was given by the Chancellor of the Exchequer in a preliminary statement to the House of Commons on Monday, 19th February, 1917. The Chancellor stated that the total amount of new money would certainly exceed £700,000,000; but the exact amount was not on that date ascertainable, because between 200,000 and 300,000 applications had yet to be examined. A week later, on Monday,

26th February, the Chancellor announced in the House that his estimate of unexamined applications had proved to be much below the mark, and that the success of the loan had exceeded all expectations, the total amount applied for having just exceeded £1,000,000,000, made up as follows—

	£
Applications through the Bank of England . . .	819,586,000
Amount of Treasury Bills converted	130,711,950
Applications through the Post Office	30,715,000
Amount received during the currency of the applications for the loan through War Savings Certificates .	19,300,000
Total	£1,000,312,950

Of the total amount applied for, only £22,000,000, or about 2 per cent. of the total, represented applications for the 4 per Cent. Tax-free Loan. For many months previous to the issue of the War Loan, the Government had been advised by sundry persons that a tax-free loan would prove very popular. The result shows that such a loan was at that time unpopular, investors preferring to accept uncertainties in the rate of future Income Tax to the deduction of a fixed rate for the duration of the loan. Later, when the daily growing cost of the war made it certain that the Income Tax must soon be raised, the 4 per Cent. Loan began to be bought, and by 7th June its price was £101, while the 5 per cent. stood at 94½.

The Chancellor's explanation of including converted Treasury Bills in the total amount of the loan was that Treasury Bills are for comparatively short dates, the average at the time the loan was issued being about four months. Sales of War Savings Certificates during the currency of the applications for the loan were included because such sales received a great impetus on account of the widespread appeals that were then made to patriotism.

With reference to the number of applications for the loan, the Chancellor's statement was as follows—

"The number of applications to this loan was, through the Bank, 1,089,000; but that does not in reality represent all the individuals, because many of these loans were made by firms on behalf of employees. The number of applications through the Post Office was 1,000,000. As regards War Savings Certificates, it is not possible to give more than an estimate, for the reason it is probable that some individuals bought more than one certificate.

There were 400,000 who took sums of £12 and upwards, and these may be regarded as individual subscribers. The number of 15s. 6d. certificates sold was 5,600,000, and it is a safe assumption that they represent an average of two to each individual. That means an addition to the subscribers of 2,800,000, making the total number of subscribers to this loan 5,289,000. Compare this with the German figures. To the fifth loan the number of subscribers was 3,810,000, to the fourth 5,280,000, again showing a falling off in the latest loan as compared with the previous loan. But, in the German loan, every subscriber of a shilling and upwards was included; but in our War Savings Committees, arrangements are made to receive, week by week, small subscriptions until they reach 15s. 6d.: and I am informed that if every applicant of that kind were taken into account, the total number of applicants to this loan would not be less than 8,000,000 people, as against the last German loan of 3,810,000, while the population of Germany is nearly 50 per cent. greater."

Further and more exact figures concerning the success of the War Loan, coupled with full particulars as to conversions of the 4½ per Cent. Loan and Exchequer Bonds, were given to the House of Commons on Wednesday, 2nd May, 1917, by the Chancellor of the Exchequer in his Budget Speech, from which the following table has been compiled.

THE GREAT WAR LOAN OF 1917[1]

	5% War Loan issued at £95.	4% War Loan issued at Par.	Total Nominal Amount.
	£	£	£
New Subscriptions, including Treasury Bills of £130,711,950	966,048,000	22,658,000	988,706,000[1]
Stock and Bonds exchanged for 4½ per Cent. War Loan 5 and 6% Exchequer Bonds	 821,005,000 282,792,000	28,726,000	1,132,523,000
Total issued against Conversions	1,103,797,000	28,726,000	1,132,523,000
Total Stock and Bonds outstanding of 5 and 4 per Cent. Loans	2,069,845,000	51,384,000	2,121,229,000

[1] Cash, 5 per Cent. Loan, £917,746,000; 4 per Cent. Loan, £22,658,000. Total, £940,404,000.

The table on page 139 is exclusive of receipts from sales of War Savings Certificates.

Not all holders of the $4\frac{1}{2}$ per Cent. Loan of 1915 and of Exchequer Bonds exercised their option to convert into the new loan, as will be seen from the following percentages given by the Chancellor in his statement—

	Of outstanding amount of		
	$4\frac{1}{2}$% War Loan.	Exchequer Bonds. 5%	6%
Percentage converted into New War Loans.	97·5	61·9	12·9

The small percentage of 6 per Cent. Exchequer Bonds converted is explained by the loss in interest up to 16th February, 1920 (date of redemption of 6 per Cent. Bonds), that would be involved to the holder by the act of conversion, though, if a permanent holder, he would probably in the long run gain by conversion.

The final figures of the great War Loan were as follows—

Exchequer Receipts	£948,459,330
NUMBER OF APPLICATIONS[1]	
Five per Cent. War Loan—	
Number of applications through the Banks of England and Ireland	1,066,111
Through the Post Office	932,742
Total	1,998,853
Four per Cent. War Loan—	
Total number of applications	24,771

An interesting feature about the new loan was that from 70 to 80 per cent. of the total amount of applications was paid up in full. Such a percentage means that the banks had to make arrangements to pay over to the Treasury, in the course of a few weeks, between £600,000,000 and £650,000,000 (after making allowance for surrender of Treasury Bills by applicants), an amount approximately equal to half the total amount of their customers' credit balances, usually termed deposits. This gigantic

[1] According to Parliamentary Papers issued 6th July, 1917.

financial operation was carried through by the Treasury disbursing the amounts daily paid over by the Joint Stock Banks to account of the War Loan almost immediately on receipt of the same, thus quickly restoring in the aggregate the deposits of customers of Joint Stock Banks and, therefore, the balances of the banks at the Bank of England. The transfer was helped by the Joint Stock Banks calling in part or the whole of their spare balances lent to the Bank of England for short periods, and by temporary borrowing to some extent from the Bank of England. The Joint Stock Banks were able to borrow from the Bank of England at 5 per cent. for a month, or 5½ per cent. for longer periods.

In its issues of 24th February, 3rd March, and 10th March, 1917, *The Economist* made the following comments on the Weekly Returns of the Bank of England, dated 21st February, 28th February, and 7th March, 1917—

> The Bank Return shows a decrease of £50,000,000 in the Government Securities, presumably due to the repayment of Ways and Means Advances by the Treasury, and an increase of £49,000,000 in the Other Securities, which may be caused by the other banks taking back money that they had lent to the Bank of England.
>
> The Bank Return showed an increase of £24,000,000 in the Other Securities, presumably caused by the other banks borrowing, or withdrawing Advances, from the Bank of England. . . .
>
> The Bank Return showed an increase of £78,500,000 in the Other Securities, and a decrease of £50,500,000 in the Government Securities, presumably because the Government has paid the Bank off and the Bank has lent to the market or to the other banks. On the liabilities side, £45,000,000 have been taken off the Other Deposits, and £73,000,000 have been added to the Public Deposits. It is a wonderful example of what book-keeping can do when it has the confidence of a rich community behind it.

When the issue of the War Loan was announced, a wish was expressed in several banking quarters that, in order to avoid heavy displacements of cash, subscriptions to the loan by customers and others should be left with the collecting bank, and be drawn against by the Government as required for disbursements, instead of being paid over to Government account at the Bank of England, as in past loans. This course of action, however, did not commend itself to the Treasury, but arrangements were made for leaving subscriptions with the collecting banks for fifteen days from date of collection before transferring to the Bank of England to War Loan Account.

In the interval between the cessation of sales of Treasury Bills, War Expenditure Certificates, and Exchequer Bonds, and the

ingathering of the proceeds of the War Loan, the war was financed by Ways and Means temporary advances from the Bank of England (in reality, the creation of credits in the books of the Bank of England), and receipt of ordinary revenue. The greater part of the proceeds of the War Loan was applied as gathered to reduction in Ways and Means Advances and payment of maturing Treasury Bills. On 31st December, 1916, the outstanding Ways and Means Advances amounted to £141,156,000. By 10th February, 1917, the amount had reached a maximum of £420,806,000. Thereafter it fell, reaching £217,526,500 on 31st March, 1917. The outstanding amount of Treasury Bills was £1,115,815,000 on 31st December, 1916; £909,046,000 on 10th February, 1917; and £463,705,000 on 31st March, 1917. The actual Exchequer receipts from the new loan up to 31st March, 1917, was £780,376,710; and the final figures £948,459,330, as stated already.

How much relatively greater was the success of the new loan than that of either of the two previous loans is better realized when it is borne in mind that the £332,000,000 loan [1] (3½ per cent.) raised in 1914 included nearly £100,000,000, and the £592,000,000 loan (4½ per cent.) raised in 1915 about £200,000,000, in the form of applications from the banks themselves. Moreover, in the case of the latter loan, an artificial stimulus was given to cash subscriptions by the amounts that had to be put in by holders of the 3½ per Cent. Loan and of Consols in order to secure the conversion rights that were then offered to them, particularly the right of further conversion at par into any future issues without further cash payment. The new loan included no direct applications from the banks; but it is true that it included a large amount (some estimates placed it as high as £200,000,000) of credit granted by the banks to the public for the purpose of subscribing to the loan. The greater part of this credit, however, has already been liquidated, and so has not tended to give rise to a permanent increase in banking deposits and the economic evils incident to further monetary inflation. But until all those who borrowed from the banks repay such loans their subscriptions are, in effect, bank subscriptions.

Finally, it has to be recorded that to a very considerable extent the success of the War Loan was due to the close co-operation

[1] Cash, £332,000,000; nominal, £350,000,000.

between the Government and the banks, and the direct encouragement given by the banks to their customers to subscribe. During the issue of the 3½ and 4½ per Cent. Loans there was some trepidation on the part of the banks as to the extent their deposits would be finally depleted by customers' subscriptions to the loans. It was later recognized by the banks, however, that the net effect of the issue of war loans on themselves is a series of internal transfers of credits among their customers and themselves. Some of the banks, it is true, after Government disbursements get more than their share of the credits of other banks; but this happens continuously in peace times, when settlement is made between the banks of final differences due to cross-crediting of customers' drawings. Once credits are created in a banking system, they can never be extinguished, unless they be permanently withdrawn in legal tender, which remains in circulation or is hoarded or sent abroad, or they are absorbed in liquidation of bank loans, public or private.

The Fourth or Victory Loan

The Victory Loan represented the fourth great loan, apart from issues of Exchequer Bonds and National War Bonds, issued since the beginning of the war. It was mainly designed to pay off a large amount of the floating debt. The first definite indication that a new loan was imminent came on 29th May, 1919, when the Chancellor of the Exchequer announced that he would seek powers on the following Monday, 2nd June, for the issue of a new loan. The necessary powers being obtained on the Monday, the prospectus of the loan was issued on 13th June, 1919. Two different issues were made: one termed "Funding Loan," the other "Victory Bonds." Both were 4 per cent. loans, but the Funding Loan was issued at £80 per cent., and is redeemable not later than 1990, with an option to the Government of redeeming in or after 1960; while the Victory Bonds were issued at £85 per cent. and are redeemable by annual drawings at par, beginning on 1st September, 1920. Subscribers to the Victory Bonds consequently paid £5 per cent. more for their investment than subscribers to the Funding Loan, but the former acquired the possibility of being holders at any time of drawn bonds, and therefore of receiving a bonus or premium of £15 per cent. at the time the bonds are drawn for redemption at par. The yield on the Funding Loan is

5 per cent., the present value of the capital bonus of 20 per cent. at the end of seventy-one years being negligible. The immediate yield on the Victory Bonds was £4 14s. per cent. The Government has undertaken in the case of each loan to set aside 2¼ per cent. each half-year on the original amount of the loan, and after paying interest on the amount outstanding to devote the balance to redemption purposes. In the case of the Funding Loan the balance is to be applied to purchases for cancellation if the price is at or under par; if the price is over par the balance will either be used for purchase or otherwise invested. In the case of the Victory Bonds, the balance of the sinking fund is to be applied to redemption of bonds drawn for payment at par. The prospectus also stated that both issues will be taken in payment of death duties: the Funding Loan at its issue price of £80 per cent.; the Victory Bonds at their full face value of £100 per cent. Payment for both issues might be made in Treasury Bills at 3½ per cent. discount, or in 4½ per Cent. War Loan; 5 per Cent. Exchequer Bonds, 1919, 1920, 1921, 1922; 6 per Cent. Exchequer Bonds, 1920; or in 4 or 5 per Cent. National War Bonds of the first, second, or third series.

The following extracts show the leading features of the prospectus issued in connection with the loan—

ISSUE OF

4 PER CENT. FUNDING LOAN,

1960-1990.

Redeemable within 71 years by means of a Sinking Fund. Interest payable half-yearly on the 1st May and 1st November. A First Dividend as follows will be paid on the 1st November, 1919—

On Allotments Applied for—	Fully-paid Allotments. % £ s. d.	Instalment Allotments. % £ s. d.
On or before the 21st June	1 9 2	0 2 3
From the 23rd June to the 28th June	1 7 7	0 1 6
From the 30th June to the 5th July	1 6 1	0 0 9
From the 7th July to 12th July	1 4 6	*nil*

on each complete £1,000 in allotments of £1,000 and upwards.

Price of Issue, £80 per cent.

Payable as follows—	%
1. For FULLY-PAID ALLOTMENTS—	
On Application	£80

2. For **INSTALMENT ALLOTMENTS**—

On Application	£5
On Tuesday, the 29th July, 1919 . . .	£10
On Thursday, the 21st August, 1919 . . .	£10
On Thursday, the 18th September, 1919 . .	£10
On Thursday, the 16th October, 1919. . .	£10
On Thursday, the 13th November, 1919 . .	£10
On Thursday, the 11th December, 1919 . .	£15
On Thursday, the 8th January, 1920 . . .	£10
	£80

The Governor and Company of the Bank of England and the Governor and Company of the Bank of Ireland are authorized to receive applications for the above Loan, which will take the form of Stock or Bonds to Bearer at the option of Subscribers ; Stock may be inscribed as " transferable in the Stock Transfer Books," or may be registered as " transferable by Deed."

Applications must be for sums which are multiples of £50, and may be for either (1) " Fully-paid Allotments," or (2) " Instalment Allotments." They will be received at the Bank of England Loans Office, 5 and 6 Lombard Street, London, E.C.3, and at the Bank of Ireland, Dublin, and may be forwarded either direct, or through the medium of any Banker or Stockbroker in the United Kingdom.

British Government Treasury Bills issued prior to the 1st June, 1919, will be accepted under discount at 3½ per cent. per annum as from the 21st June, 1919, in lieu of cash in payment for " Fully-paid Allotments," provided that the entire proceeds of the Bills are so applied. " Fully-paid Allotments " made in respect of such Applications will receive on the 1st November, 1919, the dividend payable on that date in respect of " Fully-paid Allotments " applied for on or before the 21st June, 1919.

Stock and Bonds of the undermentioned Issues will be accepted at par as the equivalent of cash in payment, in whole or in part, for " Fully-paid Allotments " of this Issue—

£4 10s. per Cent. War Loan, 1925–1945.
£5 per Cent. Exchequer Bonds, 1919, 1920, 1921, and 1922.
£6 per Cent. Exchequer Bonds, 1920.
£4 per Cent. National War Bonds, 1st, 2nd, and 3rd Series.
£5 per Cent. National War Bonds, 1st, 2nd, and 3rd Series.

His Majesty's Government undertake to set aside at the close of each half-year a sum equal to 2½ per cent. on the nominal amount of the Loan originally created. After deducting therefrom the amount required for payment of Interest on the Loan for the half-year, the balance of the sum so set aside will be carried to a Sinking Fund which will be applied during the succeeding half-year to the purchase of the Loan for cancellation if the price is at or under par ; when the price is above par it will be either so applied or otherwise invested under the control of His Majesty's Treasury. Any outstanding balance of the Loan not previously redeemed will be repaid at par on the 1st May, 1990, but His Majesty's Government reserve to themselves the right, on giving three calendar months' notice in the *London Gazette*, to redeem at par at any time on or after the 1st May, 1960, any outstanding balance of the Loan not previously purchased and cancelled by the operation of the Sinking Fund.

Stock and Bonds of this issue will be accepted by the Commissioners of Inland Revenue as the equivalent of cash on the basis of £80 cash for each £100 Stock or Bonds surrendered, with due adjustment on account of interest, in satisfaction of amounts due on account of Death Duties, provided that

the Stock or Bonds surrendered have formed part of the estate passing on death of the deceased continuously up to the date of death from the date of the original subscription or for a period of not less than six months immediately preceding the date of death. Stock and Bonds so surrendered and outstanding will be held for account of His Majesty's Government until redeemed by the operation of the Sinking Fund or until the final redemption of the Loan; any portion of the Sinking Fund applied in any half-year to the purchase for cancellation of Stock or Bonds so held will bear to the total of the Sinking Fund available a ratio not exceeding that which the Stock and Bonds so held at the commencement of such half-year bore to the total of the Loan then outstanding.

Stock will be convertible into Bonds to Bearer (in denominations of £50, £100, £200, £500, £1,000, and £5,000) with coupons attached for the Interest payable half-yearly, and Bonds will be convertible into Stock without payment of any fee. Stock will be transferable in any sums which are multiples of a penny.

The Instalments payable in respect of "Instalment Allotments" may be paid in full on or after the 29th July, 1919, under discount at the rate of 3½ per cent. per annum. Where payment in full is made between two instalment dates, discount will be calculated as from the instalment date next succeeding the date of such full payment. In case of default in the payment of any instalment by its proper date, the deposit and any instalments previously paid will be liable to forfeiture. Payments may be made without additional charge at Offices of the undermentioned Banks in the United Kingdom.

The List of Applications will be closed on Saturday, the 12th July, 1919.

BANK OF ENGLAND, *12th June*, 1919.

ISSUE OF

4 PER CENT. VICTORY BONDS

Redeemable at par by a cumulative Sinking Fund operating by means of Annual Drawings commencing 1st September, 1920. Interest payable half-yearly on the 1st March and 1st September. First Dividends as follows will be paid on the 1st March, 1920—

On Allotments Applied for—	Fully-paid Allotments % £ s. d.	Instalment Allotments % £ s. d.
On or before the 21st June . .	2 15 9	1 6 3
From the 23rd June to the 28th June	2 14 3	1 6 2
From the 30th June to the 5th July	2 12 8	1 6 1
From the 7th July to the 12th July .	2 11 2	1 6 0

Price of Issue, £85 per cent.

Payable as follows—

1. For FULLY-PAID ALLOTMENTS— %
   On Application £85

2. For INSTALMENT ALLOTMENTS—

On Application	£5
On Friday, the 8th August, 1919 . . .	£10
On Thursday, the 4th September, 1919 . .	£10
On Thursday, the 2nd October, 1919 . .	£15
On Thursday, the 30th October, 1919 . .	£10
On Monday, the 24th November, 1919 . .	£10
On Thursday, the 11th December, 1919 . .	£10
On Thursday, the 8th January, 1920 . . .	£15
	£85

The Governor and Company of the Bank of England and the Governor and Company of the Bank of Ireland are authorized to receive applications for the above Bonds, which will be issued in denominations of £50, £100, £200, £500, £1,000, and £5,000.

Applications may be for either " Fully-paid Allotments " or " Instalment Allotments." They will be received at the Bank of England Loans Office, 5 and 6 Lombard Street, London, E.C.3, and at the Bank of Ireland, Dublin, and may be forwarded either direct or through the medium of any Banker or Stockbroker in the United Kingdom.

British Government Treasury Bills issued prior to the 1st June, 1919, will be accepted under discount at 3½ per cent. per annum as from the 21st June, 1919, in lieu of cash in payment for " Fully-paid Allotments," provided that the entire proceeds of the Bills are so applied. " Fully-paid Allotments " made in respect of such applications will receive on the 1st March, 1920, the dividend payable on that date in respect of " Fully-paid Allotments " applied for on or before the 21st June, 1919.

Stock and Bonds of the undermentioned Issues will be accepted at par as the equivalent of cash in payment, in whole or in part, for " Fully-paid Allotments " of this Issue—

£4 10s. per Cent. War Loan, 1925–1945.
£5 per Cent. Exchequer Bonds, 1919, 1920, 1921, and 1922.
£6 per Cent. Exchequer Bonds, 1920.
£4 per Cent. National War Bonds, 1st, 2nd, and 3rd Series.
£5 per Cent. National War Bonds, 1st, 2nd, and 3rd Series.

His Majesty's Government undertake to set aside at the close of each half-year a sum equal to 2¼ per cent. on the nominal amount of the Bonds originally created. After deducting therefrom the amount required for payment of interest on the Bonds for the half-year, the balance of the sum so set aside will be carried to a Sinking Fund which will be applied by means of annual drawings to the redemption of the Bonds at par (including Bonds which have been surrendered to the Commissioners of Inland Revenue for death duties as hereinafter provided), the Bonds to be redeemed in each year being determined by lot and paid off on the 1st September in such year, in accordance with regulations made by the Treasury. The numbers of the Bonds drawn for redemption on each occasion will be advertised in the *London Gazette* not less than two months prior to the date of redemption. Interest on Bonds drawn for repayment will cease from the date on which the Bonds become repayable. The first drawing will be that for the Bonds to be redeemed on the 1st September, 1920.

Bonds of this Issue will be accepted at their face value by the Commissioners of Inland Revenue as the equivalent of cash, with due adjustment on account of interest, in satisfaction of amounts due on account of death duties, provided that the Bonds surrendered have formed part of the estate passing on death of the deceased continuously up to the date of death from

the date of the original subscription or for a period of not less than six months immediately preceding the date of death. Bonds surrendered under these provisions will be held for account of His Majesty's Government until drawn for redemption as provided in the preceding paragraph.

The instalments payable in respect of "Instalment Allotments" may be paid in full on or after the 8th August, 1919, under discount at the rate of 3½ per cent. per annum. Where payment in full is made between two instalment dates, discount will be calculated as from the instalment date next succeeding the date of such full payment. In case of default in the payment of any instalment by its proper date, the deposit and any instalments previously paid will be liable to forfeiture. Payments may be made without additional charge at Offices of the undermentioned Banks in the United Kingdom.

The List of Applications will be closed on Saturday, the 12th July, 1919.

BANK OF ENGLAND, 12*th June*, 1919.

The lists opened on 13th June, 1919, and closed on 12th July, 1919. As in the case of past loans, a widespread campaign to popularize the new loan was undertaken by the Government, loyally and unanimously supported by the Press, the banks, and the stockbrokers. The banks and stockbrokers sent out to their customers a copy of the prospectus, accompanied by a strong letter-appeal from the Chancellor of the Exchequer. The banks publicly advertised that they were prepared to grant loans to enable applicants to subscribe to the Victory Loan, provided the applicants were in a position to pay off the advances within a reasonable time. In the case of this loan, however, the amount so advanced was small.

The final totals of the subscriptions to the Victory Loan were announced by the Chancellor of the Exchequer on 30th July, 1919, to be as follows—

CASH APPLICATIONS	£
Funding Loan	287,956,000
Victory Bonds	286,748,000
	574,704,000

of which total, £18,744,250 was paid for in Treasury Bills

CONVERSIONS	£
Funding Loan	120,617,000
Victory Bonds	72,203,000
	192,820,000

Cash applications and conversions totalled to £767,524,000.

On the same day, the Chancellor of the Exchequer stated in a written answer that direct subscriptions by banks in their own names had been: Funding Loan, £37,692,000; Victory Bonds, £73,351,000; or a total of about £111,000,000. This creation of further credit by the banks was bad finance, and must inevitably have led to further inflation with all its attendant evils. That such a form of subscription should have been encouraged is remarkable, in view of the statement of the Chancellor of the Exchequer at the time the lists were opened that one of the main objects of the loan was to improve the National Credit. It would have been far preferable that the total of the loan should have been less by £111,000,000. This last creation of credit may in future cost the Government, through indirect means, considerably more than the amount created for the purpose of swelling the total of the loan.

The actual Exchequer receipts from the loan up to 31st March, 1921, was £475,841,823.

The main reason why the cash subscriptions to the Victory Loan were not considerably greater than they were was that subscriptions to previous loans, after Government disbursement, had mainly gravitated to the accounts of producers, traders, and business men generally. Ordinary depositors of banks had well supported the earlier loans, and had not had time to build up their deposits again for further subscription to loans. The reason given by business men, when they were asked why they had not subscribed large amounts to the last loan, was generally: "We now require from two to three times as much liquid money to run our businesses as we did before the war, on account of higher prices and increased wages." Thus, the country reaped the evils of inflation through the operation of the vicious circle.

War Savings Certificates[1]

These have been issued since 19th February, 1916 (price 15s. 6d. each), at first at any Money Order Office of the Post Office, later also at banks. Each certificate entitles the purchaser to £1 at the end of five years; meanwhile, the money will be repaid if required: 15s. 6d. during the first year, 15s. 9d. at the end of one year, and an additional 1d. for each succeeding month. Each purchaser receives a book, in which a receipt for the payment is inserted.

[1] The name was changed to National Savings Certificates in June, 1920.

It was later stated that, in order to meet the requirements of those who were able to purchase a considerable number of certificates at a time, certificates for £12 and £25 (purchase price £9 6s. and £19 7s. 6d.) would be issued. These £12 and £25 certificates are issued without books, the certificate itself taking the place of a book. Single certificates for amounts of £26 and upwards were also issued later. The amount of certificates that any individual may hold is restricted to 500; purchase price, £387 10s.

No Income Tax is payable in respect of the accumulated interest on War Savings Certificates. At first, only people whose income did not exceed £300 a year could purchase these certificates, but this limit was removed on 8th June, 1916; and on the same day it was also announced that single certificates for £500, payable five years hence (purchase price £387 10s.), would be issued to meet the convenience of those who desired to buy 500 certificates at one purchase.

During the issue of the 5 per cent. War Loan (12th January-16th February, 1917), and for about three weeks afterwards, sales of War Savings Certificates showed a considerable expansion, as is disclosed by the table appended—

WEEKLY EXCHEQUER RECEIPTS FROM SALES OF WAR SAVINGS CERTIFICATES FOR PERIOD 26TH NOVEMBER, 1916—31ST MARCH, 1917

Week ending	Receipts £	Week ending	Receipts £
Dec. 2 1916 . .	1,050,000	Feb. 3 1917 . .	2,000,000
" 9 " . .	900,000	" 10 " . .	3,000,000
" 16 " . .	900,000	" 17 " . .	5,000,000
" 23 " . .	600,000	" 24 " . .	7,000,000
" 30 " . .	300,000	Mar. 3 " . .	4,000,000
Jan. 6 1917 . .	1,000,000	" 10 " . .	3,500,000
" 13 " . .	1,200,000	" 17 " . .	1,000,000
" 20 " . .	1,100,000	" 24 " . .	200,000
" 27 " . .	1,500,000	" 31 " . .	2,000,000

The increased sales of War Savings Certificates during the period 13th January-10th March, 1917, was undoubtedly due to the widespread nature of the public and Press appeals that were made to patriotism whilst the application lists for the new War Loan remained open. People who did not desire or see their way to

subscribe to the War Loan "did their bit" by purchasing War Savings Certificates.

In the fourth Annual Report issued by the National Savings Committee there appeared the following classification of sales of War Savings Certificates since they were first issued and up to 31st December, 1920. The table is interesting as proving that the greater amount of Exchequer Receipts from this form of borrowing has been through sales of certificates for £25 and upwards.

CLASSIFICATION OF SALES OF WAR SAVINGS CERTIFICATES

From 19th February, 1916, to 31st December, 1920

		£	s.	d.
115,131,908	Single Certificates at 15s. 6d. . . .	89,227,228	14	0
27,836	£5 Certificates at £3 17s. 6d. . . .	107,864	10	0
2,976,566	£12 Certificates at £9 6s.	27,682,063	16	0
4,029,024	£25 Certificates at £19 7s. 6d. . .	78,062,340	0	0
762,446	Single Certificates from £26 to £499 . .	84,635,355	5	0
159,038	£500 Certificates at £387 10s. . .	61,627,225	0	0
123,086,818	Equivalent to 440,441,390 single 15s. 6d. Certificates of the total value of . .	£341,342,077	5	0

Repayments (including exchanges for War Loan, etc.) up to 31st December, 1920, £61,404,669, leaving net sum invested of £279,937,408.

The following table shows the yearly Exchequer receipts from sales of War Savings Certificates since they were first issued—

YEARLY EXCHEQUER RECEIPTS FROM SALES OF WAR SAVINGS CERTIFICATES

Year ending 31st March.	Receipts.	Weekly Average
	£	£
1916 (six weeks)	1,250,000	208,000
1917	72,750,000	1,399,000
1918	62,200,000	1,196,000
1919	89,500,000	1,721,000
1920	72,310,000	1,391,000
1921	41,131,000	791,000
1921 (1st April to 28th May) .	5,380,000	649,000
Total receipts to 28th May, 1921 .	344,521,000	

Up to date, approximately 18 per cent. of the amount invested in War Savings Certificates has been withdrawn by the subscribers.

By a resolution passed in Committee in the House of Commons on 7th July, 1920, it was agreed that one-half of the future proceeds of National Savings Certificates should be invested in Local Housing Loans.

Early in 1921 it was announced that the life of War Savings Certificates falling due for payment might be extended from five to ten years.

The main object of the issue of War Savings Certificates was to attract small sums from the working classes. The scheme succeeded in this object, but it is well known that a large part of the actual receipts from sales of such certificates was derived from people who purchased the certificates on account of their non-liability to Income Tax deduction. This particularly applies to certificates sold for amounts of £200–£500.

War Expenditure Certificates

On 3rd June, 1916, the Treasury announced that as from that day, until further notice, War Expenditure Certificates would be issued at a fixed rate of discount, which would be subject to variation from time to time without previous notice. The Certificates were issued in amounts of £1,000, £5,000, and £10,000, and were drawn for two years from date of issue. Particulars of the rate of discount for the time being in force was notified to applicants at the Bank of England. The Treasury later gave notice that from 26th June, 1916, these certificates would also be issued for amounts of £100 and £500. War Expenditure Certificates were, in effect, Treasury Bills running for two years. At first, they were issued at a price of 90 per cent., which price, on the basis of annual interest, yielded the holder about £5 8s. per cent. per annum. Then, when the Bank Rate was raised to 6 per cent., on 13th July, 1916, the price of the certificates was lowered to £89, at which price they remained until their issue was discontinued on 1st January, 1917 (along with Exchequer Bonds), in view of the imminence of a new War Loan. Since their date of first issue (3rd June, 1916), they yielded to the Exchequer £23,561,000 net. (Total receipts, £29,878,500, less £6,317,500, representing cancellation of certificates tendered as subscription to the War Loan.) War Expenditure Certificates have not been re-issued since 1st January, 1917.

Treasury Bills

In the early months of the war, the Government made several issues of Treasury Bills on the tender system. The following table gives the particulars of these issues—

Date Issued.	Amount.	Period.	Average Rate of Allotment.
1914	£		£ s. d.
August 19 . .	15,000,000	Six months	3 13 1
„ 26 . .	15,000,000	„ „	3 15 6
September 16 . .	7,500,000	„ „	2 18 6
„ 16 . .	7,500,000	Twelve months	3 8 3
October 7 . .	15,000,000	Six months	3 9 3
„ 21 . .	15,000,000	„ „	3 14 11
November 4 . .	15,000,000	„ „	3 13 7
1915			
February 23 . .	10,000,000	„ „	1 12 3
„ 23 . .	10,000,000	Twelve months	2 17 1
March 30 . .	15,000,000	Six months	2 13 11
April 6 . .	15,000,000	„ „	3 2 1
„ 13 . .	15,000,000	„ „	3 14 4
Total of Issues . .	£155,000,000		

On 13th April, 1915, the Treasury announced that, until further notice, Treasury Bills would be issued daily, for unlimited amounts, in denominations of £1,000, £5,000, and £10,000, drawn for three, six, or nine months from date of issue, at fixed rates of discount, which would be subject to variation from time to time without previous notice, the rates in force for the time being to be notified to applicants at the Bank of England. Bills for twelve months were later added to the scheme. It is, perhaps, worthy of note that Treasury Bills were authorized as an investment for the money deposited in the Special Investment Departments of Trustee Savings Banks.

This departure of the Treasury from the old system of tender for bills deserves commendation. On the new system applicants know the exact rate of discount before application. The Treasury is able to regulate, to some degree, the rate of inflow of money by altering its rates from time to time.

The discount rates on these Bills varied as follows, until the new system was temporarily discontinued, as from 4th January, 1917—

TREASURY BILLS AT FIXED RATES

Date of Fixing.	Rates per cent. per annum.			
	3 months.	6 months.	9 months.	12 months.[2]
1915.				
April 14 . . .	$2\frac{3}{4}$	$3\frac{5}{8}$	$3\frac{3}{4}$	$3\frac{3}{4}$
August 9 . . .	$4\frac{1}{2}$	$4\frac{1}{2}$	$4\frac{1}{2}$	$4\frac{1}{2}$
October 27 . . .	$4\frac{3}{4}$	$4\frac{7}{8}$	5	5
November 12. . .	5	5	5	5
1916.				
March 24 . . .	$4\frac{1}{2}$	$4\frac{3}{4}$	$4\frac{3}{4}$	5
June 16 . . .	5	5	5	5
July 14 . . .	$5\frac{1}{2}$	$5\frac{3}{4}$	[1]	6
Spetember 27 . .	$5\frac{1}{2}$	$5\frac{1}{2}$		$5\frac{1}{2}$

The issue of nine months maturities was discontinued from 14th July, 1916. The object of the reduction on 27th September, 1916, in the rates of discount for six and twelve months maturities, from $5\frac{3}{4}$ per cent. and 6 per cent. respectively (the rates in operation since 14th July, 1916) to the uniform rate of $5\frac{1}{2}$ per cent., the ruling rate for three months maturities, was to divert as much new money as possible from Treasury Bills to the new 6 per cent. Exchequer Bonds to be issued from 2nd October, 1916, and repayable on 16th February, 1920, on account of the longer-dated character of the Exchequer Bonds. For some time previous to the reduction in rates, the large and growing amount of outstanding Treasury Bills had met with disapproval from certain financial quarters. But notwithstanding the extra $\frac{1}{2}$ per cent. interest afforded by investment in Exchequer Bonds, the amount of outstanding Treasury Bills still continued to increase after the reduction in rates. The amount of such bills outstanding on 30th September, 1916, was £1,041,488,000. By 16th December it had grown to £1,148,545,000 (an increase of £107,057,000), the maximum amount recorded as outstanding at the end of any week during the first three years of war. On 9th December, the amount was £1,148,471,000 ; on 23rd December, £1,148,116,000 ; and on 30th December, £1,115,815,000.

The popularity of Treasury Bills is undoubtedly due to their

[1] Sales ceased.
[2] Issue of 12 months' bills commenced on 8th May, 1915.

short-term character. Prior to the war, their purchase was almost entirely confined to banks and financial houses; but the new system of sales at advertised fixed rates of discount soon brought a growing demand for them from the ordinary investor. The Treasury Bill provides a convenient form of investment for institutions and sundry persons who have payments to make in the near future. Not only so, but banks, financial houses, and many ordinary investors like to have the feeling that an inflow of money will be available at definite dates in the near future, if then required for any purposes.

On Thursday, 4th January, 1917, the Government announced that no further sales of Treasury Bills would be made at present. This entire cessation was obviously due to the imminence of the new War Loan, the prospectus of which appeared on 12th January. As old bills matured, and while new bills were not available, the outstanding amount rapidly declined, reaching a minimum of £454,478,000 (on 14th April) for the third year of war. The reduction of £694,067,000 in the outstanding amount between 16th December, 1916, and 14th April, 1917, it should be observed includes Treasury Bills to the amount of £130,711,950 tendered as subscriptions to the new War Loan, in accordance with the terms of the prospectus.

The proceeds of the new War Loan having been applied mainly to part payment of Ways and Means temporary advances (which had greatly increased after the cessation of sales of Treasury Bills) and to meeting maturing Treasury Bills, it soon became obvious that the Government would be driven to an early resumption of sales of Treasury Bills, in the absence of sufficient receipts from issues of other forms of popular loans. On 23rd March, 1917, it was announced that sales of Treasury Bills would shortly be resumed on the old pre-war system of tender, in denominations of £1,000, £5,000, and £10,000 as before, and drawn for three, six, or twelve months. The first batch of such bills offered amounted to £50,000,000, to be tendered for on Friday, 30th March, and paid for on Tuesday, 3rd April. The result of the offer was that applicants for three months' bills at £98 16s. 3¾d. and above, and for six months' bills at £97 11s. 2d. and above, had their tenders accepted in full. Tenders for twelve months' bills at £95 received about 96 per cent. of the amounts applied for.

Further issues of Treasury Bills on the tender system (until its withdrawal in June) are shown in the following table—

TREASURY BILLS ISSUED BY TENDER DURING THIRD YEAR OF WAR. MINIMUM PRICES ACCEPTED FOR PART OR WHOLE OF THE BILLS

(Average Rate not disclosed by Treasury)

Date of Bills.	Amount offered.	Three Months.	Six Months.	Twelve Months.
1917.	£	£ s. d.	£ s. d.	£ s. d.
April 3 . .	50,000,000	98 16 3¾	97 11 2	95 0 0
„ 17 . .	50,000,000	98 16 4	97 11 2½	95 0 0½
„ 24 . .	50,000,000	98 15 10	97 10 6¼	95 0 0
May 1 . .	20,000,000	98 15 9¼	97 10 11½	95 0 0
„ 8 . .	20,000,000	98 15 10½	97 11 6	95 1 6
„ 15 . .	25,000,000	98 15 8½	97 11 5½	95 2 6
„ 22 . .	20,000,000	98 16 0½	97 12 1	95 2 6
„ 29 . .	30,000,000	98 15 11½	97 12 0	95 2 6
June 5 . .	40,000,000	98 15 9½	97 11 10	95 2 6
„ 12 . .	25,000,000	98 16 0¾	97 12 4½	95 2 6¼
„ 19 . .	25,000,000	98 15 9½	97 11 10	95 2 6¼
Total of issues	£355,000,000			

It is not possible to deduce the average rates of discount at which the various batches of bills issued on the tender system during the third year of the war were placed with purchasers, on account of the meagre amount of information the Treasury published concerning the allotments. All that it is possible to state is that the bills issued since the resumption of sales on 3rd April, 1917, were placed at rates at least less by ½ to ¾ per cent. than the 5½ per cent. rate ruling at the time of the cessation of fixed rate sales on 4th January, 1917.

On Monday, 23rd April, 1917, it was announced that, in addition to definite amounts of Treasury Bills being offered for sale from time to time on the system of tender, applications would also be received from 28th April for limited amounts of bills at advertised fixed rates of discount, such rates, in the event of tenders for an issue of bills having been received during the preceding seven days, to be less than the average rates of allotment in respect of such issues. Obviously, with the desire not to divert the ordinary investor from the new issue of 5 per cent. Exchequer Bonds (which issue commenced on 13th April, 1917) to Treasury Bills, the Treasury also announced that applications for Treasury Bills at

fixed rates of discount would only be received from banks and discount houses, the minimum application to be for £25,000. The advertised fixed rates for bills purchasable under this scheme, until its withdrawal in June, are shown in the table appended—

FIXED RATES FOR "INTERMEDIATE" TREASURY BILLS

Date Rate Fixed.	Three Months.		Six Months.		Twelve Months.	
	Price.	Rate.	Price.	Rate.	Price.	Rate.
1917.	£ s. d.	%	£ s. d.	%	£ s. d.	%
April 28 . .	98 16 11¼	4⅝	97 13 7½	4⅝	95 2 6	4⅞
May 5 . .	98 16 8¼	4⅝	97 13 7½	4⅝	95 3 9	$4\frac{13}{16}$

After eleven issues under the tender system, aggregating to £355,000,000 since the end of March, 1917, the Treasury announced on Monday, 18th June, the discontinuance of the tender system and the resumption, from 19th June until further notice, of daily sales of Treasury Bills at fixed rates of discount, subject to variation from time to time without previous notice. The bills were to be issued in amounts of £1,000, £5,000, and £10,000, and to be drawn for three, six, and twelve months. The suspension of the tender system restored the Treasury Bill procedure practically to what it was when the daily sale system was discontinued on 4th January, 1917. Payment for bills issued on the new daily system might, however, be made to the Bank of England not later than the day following the sale. On the former daily system, payment had to be made on the day of issue. The rate for three and six months' bills offered for sale was fixed at 4½ per cent. on 19th June, and raised to 4¾ per cent. on 3rd July. Thereafter, several changes were made at different dates. No offer was made of twelve months' bills until 19th March, 1920, presumably because the Treasury wished to encourage purchases of 5 per cent. Exchequer Bouds.

On 24th August, 1917, it was announced that periodical issues of British Treasury Bills would be placed on the money market of the United States, the total amount then authorized being $150,000,000.

The issue of Treasury Bills (and National War Bonds) was suspended from 31st May, 1919, in view of the imminence of the issue of the Victory Loan on 13th June, 1919.

Daily sales of Treasury Bills were resumed by the Government on 14th July, 1919, for two, three, and six months' maturities. The two months were, however, withdrawn a month later, on 14th August. Six months' maturities were withdrawn from 19th March, 1920, and replaced by yearlings. On 29th April, 1920, it was announced that twelve months' Treasury Bills were no longer on offer, and that three months' bills would henceforward not be issued in lower denominations than £5,000. Resumption of sale of yearling bills commenced on 11th March, 1921.

The following table shows the discount rates on Treasury Bills issued on the "fixed rates" system since 19th June, 1917—

Treasury Bills at Fixed Rates

Date of Fixing.	Rates per cent. per annum.			
	2 months.	3 months.	6 months.	12 months.
1917.				
June 19 . . .	—	4½	4½	—
July 3 . . .	—	4¾	4¾	—
Dec. 27 . . .	—	4	4	—
1918.				
Feb. 14 . . .	—	3½	3½	—
1919.				
May 31 (Sales suspended) . .	—	—	—	—
July 14 (Sales resumed) . .	3⅜	3½	4	—
Aug. 14 . . .	—	3½	4	—
Oct. 6 . . .	—	4½	5	—
Nov. 7 . . .	—	5½	5½	—
1920.				
March 19 . . .	—	5½	—	5½
April 14 . . .	—	6½	—	6½
,, 29 . . .	—	6½	—	—
1921.				
March 11 . . .	—	6	—	6
April 21 . . .	—	[1]	—	6
,, 26 . . .	—	[1]	—	5¾
June 23 . . .	—	[1]	—	5½
,, 30 . . .	—	[1]	5½	—
July 7 . . .	—	[1]	—	—

[1] For rate see particulars and table on the next page.

On 11th April, 1921, the Chancellor of the Exchequer announced in the House of Commons a system of weekly sales by tender of Treasury Bills of fixed amounts, to be initiated on Thursday, 21st April, which is still in operation at the time of writing.

Tenders must be made by or through a bank, discount house, or broker, and the minimum amount that is considered is £50,000. The bills are issued in denominations of £5,000 and £10,000 and are dated at the option of the tenderer on any business day during the following week. In addition to the bills offered for tender, applications are received for "additional" Treasury Bills, to be dated the business day next succeeding the date of application, at rates advertised each week, such rates being based on, but being less than, the average rate at which bills of like tenor were sold by tender on the Thursday of the preceding week. Since the system commenced on 21st April, both classes of applications have been confined to three month maturities. Twelve month bills were not affected by the new arrangements, but the rate for such bills was reduced from 6 to 5¾ on 26th April, and to 5½ on 23rd June. A week later, on 30th June, yearlings were withdrawn and six month maturities offered at the same rate. On 7th July, the latter were withdrawn from sale.

The following table shows the results of the tender system since it again came into operation on 21st April, 1921, and up to 8th July, 1921, the rate for "additional" bills being shown in the last column.

TREASURY BILLS ISSUED BY TENDER
(Three Month Maturities)

Date.	Amount Offered.	Amount Applied for.	Average Rate of Discount of Tenders Accepted.	Rate for Additional 3 Month Bills.
1921.	£	£	£ s. d.	
April 21	50,000,000	51,930,000	5 19 3·95	5⅝
April 28	50,000,000	76,735,000	5 14 5·64	5⅜
May 5	50,000,000	94,620,000	5 12 11·18	5⅜
May 12	45,000,000	93,355,000	5 11 2·81	5¼
May 20	45,000,000	65,565,000	5 14 11·02	5⅜
May 27	55,000,000	72,490,000	5 13 1·83	5⅜
June 3	55,000,000	84,775,000	5 12 1·06	5¼
June 10	40,000,000	83,975,000	5 12 2·28	5¼
June 17	40,000,000	82,670,000	5 10 1·06	5¼
June 24	55,000,000	96,485,000	5 6 8·89	5
July 1	60,000,000	77,540,000	5 7 3·34	5
July 8	55,000,000	117,220,000	5 3 6·64	4⅞

It is obvious from the above table that since the tender system was resumed, discount rates have materially moved in favour of the Government.

The following table shows the amount of Treasury Bills outstanding at yearly intervals since 7th August, 1915—

TREASURY BILLS OUTSTANDING

At	Amount Outstanding.	Increase + Decrease −
	£	£
August 7, 1915	236,322,000	+ 220,822,000
„ 5, 1916	856,557,000	+ 620,235,000
„ 4, 1917	757,977,000	− 98,580,000
„ 3, 1918	1,055,027,000	+ 297,050,000
„ 2, 1919	749,678,000	− 305,349,000
July 31, 1920	1,058,348,000	+ 308,670,000
July 23, 1921	1,207,187,000	+ 148,839,000

The amount of Treasury Bills outstanding at different times in each year has been greater than the amounts shown in the above table. The proceeds of War Loans has usually only reduced such amount temporarily. At the end of 1918, Treasury Bills outstanding amounted to £1,094,740,000. At the end of 1919 the amount was £1,106,150,000. Its lowest point during 1919 was £628,000,000 on 12th July. At the end of 1920 the amount outstanding was £1,102,109,000.

Treasury Bills held by the Joint Stock Banks are a very powerful means at their disposal for increasing their balances at the Bank of England. By omitting at any time to renew at maturity, they compel the Government to borrow from the Bank of England in the form of Ways and Means Advances, unless the Government is able to meet the maturing bills out of the proceeds from War Loans or receipts from taxation. Furthermore, any increase in their balances at the Bank of England places the Joint Stock Banks in a position to take further supplies of Currency Notes from that institution. Treasury Bills are therefore an excellent investment for the Joint Stock Banks, but the sooner such bills and Ways and Means Advances are considerably reduced, the better will be the financial position of the country as a whole. The floating debt is responsible for a large amount of the inflation that has taken place since the year 1914. It has, in fact, provided part of the so-called cash basis of the great expansion in bank credit. As this temporary cash basis is reduced in the future, so must there necessarily be a considerable reduction in bank credit.

Ways and Means Advances

The amount of temporary advances outstanding

At 5th August,	1916	was	£53,396,000
„ 4th „	1917	„	£246,131,000
„ 3rd „	1918	„	£323,414,000
„ 2nd „	1919	„	£431,577,000
„ 31st July,	1920	„	£203,841,000
„ 23rd „	1921	„	£145,474,000

As in the case of Treasury Bills, the amount of Ways and Means Advances outstanding at different times in each year has fluctuated considerably, decreases taking place after the ingathering of the proceeds of War Loans. Ways and Means Advances, which were £455,100,000 at the end of 1918, rose to £930,500,000 on 12th July, 1919, but by 31st December, 1919, they had diminished to £243,174,000. Since the commencement of April, 1920, the Treasury in its returns has made a separation of Ways and Means Advances by the Bank of England from those by Public Departments (figures for a year previously also being given for the purpose of comparison).

The Floating Debt

The floating debt on 4th August, 1917 (outstanding Treasury Bills plus outstanding Ways and Means Advances) amounted to £1,004,108,000 ; on 2nd August, 1919, to £1,181,255,000 ; on 31st July, 1920, to £1,262,189,000 ; and on 23rd July, 1921, to £1,352,661,000.

Though considerable reduction was effected in the floating debt during the last six months of 1919, the table on following page shows no further net reduction effected since the end of that year.

An interesting item in this table is the outstanding amount, on 30th June, 1919, of £529,000,000 advanced by the Bank of England to the Government. On 12th July, 1919, such advances had grown to £703,000,000. These large amounts are not to be reconciled with the amount of Government Securities in the Banking Department, which on 25th June, were £67,000,000 ; on 2nd July, £99,000,000 ; and on 9th July, £137,000,000. The large outstanding amounts of Bank of England advances on the named dates have presumably some connection with Government borrowings of the spare balances of other banks, through the medium of the Bank of England, a subject which was considered in the last chapter.

OUTSTANDING AMOUNTS IN MILLION £'S.

At	Treasury Bills.	Ways and Means Advances.			Total Floating Debt.
		By Bank of England.	By Public Departments.	Total.	
1914 Aug. 1[1] .	15	(Not separ	ated)	1	16
1918 Nov. 9[2] .	1,124	(Not separ	ated)	366	1,490
1919 June 30[3] .	796	529	245	774	1,570[4]
„ Dec. 31 .	1,106	56	187	243	1,349
1920 March 31 .	1,107	—	205	205	1,312
„ June 30 .	1,050	70	174	244	1,294
„ Sept. 30 .	1,139	—	143	143	1,282
„ Dec. 31 .	1,102	87	219	306	1,408
1921 March 31 .	1,121	—	154	154	1,275
„ June 30 .	1,222	39	113	152	1,374
„ July 23 .	1,207	18	127	145	1,352

[1] War declared between Great Britain and Germany, 4th August, 1914.
[2] Armistice made with Germany, 11th November, 1918.
[3] Peace Treaty signed 28th June, 1919.
[4] Highest outstanding amount at any time.

On 23rd July, 1919, the Bank of England ceased to allow interest on three-day deposits made by the other banks, and it is noteworthy that from this time Bank of England outstanding advances to the Government (according to Treasury Returns) rapidly decreased, but the outstanding amount of Treasury Bills showed considerable expansion.

Ways and Means Advances by Public Departments presumably represent sums past due or due to the spending departments from the Treasury. Part of such advances may also represent loans by Public Departments out of actual balances standing to their credit at the Bank of England.

EXCHEQUER, NATIONAL WAR, AND TREASURY BONDS

EXCHEQUER BONDS. Early in March, 1915, the Treasury made an issue of £50,000,000 Exchequer Bonds in the form of five-year 3 per cent. bonds. The system of tendering without a minimum price was adopted, and the result was that the total applications amounted to £72,000,000, while the average price accepted was about £3 18s. The net Exchequer receipts were £47,942,345.

On 16th December, 1915,[1] the Treasury announced that Exchequer Bonds, carrying interest at £5 per cent. per annum and repayable at par on 1st December, 1920, would be issued daily, for an unlimited amount, in denominations of £100, £200, £500, £1,000, and £5,000. The bonds were obtainable through the Bank of England or any other bank. It was also stated that in the event of future loans (other than issues made abroad or issues of Exchequer Bonds, Treasury Bills, or similar short-dated securities), bonds of this issue would be accepted, together with all undue coupons, as the equivalent of cash for subscription to any such loan. On 10th January, 1916, similar bonds were issued in denominations of £5, £20, and £50 at Money Order offices. Subscribers at their option might leave their bonds in the custody of the Post Office. It was later announced that applications for the small bonds could also be made at all the banking institutions in the country.

The issue of Exchequer Bonds repayable on 1st December, 1920, ceased on 1st June, 1916; but applications were still accepted for 5 per cent. Exchequer Bonds repayable on 5th October, 1919, or on 5th October, 1921, at the option of the applicant. On 25th May, 1916, it was announced that Exchequer Bonds issued through the Post Office would continue to be 5 per cent. bonds, in denominations of £5, £20, and £50, maturing 1st December, 1920.

On Wednesday, 27th September, 1916, the Treasury announced the cessation of sales of the Exchequer Bond issue repayable 5th October, 1919; and the issue from 2nd October, 1916, of new bonds repayable 16th February, 1920, bearing interest at 6 per cent. per annum, payable half-yearly on 16th February and 16th August, in denominations of £100, £200, £500, £1,000, and £5,000, as before. The prospectus also stated (as in the case of the 5 per cent. bonds and the 4½ per cent. loan) that in the event of future loans (other than issues made abroad or issues of Exchequer Bonds,

[1] This date marks the commencement of the day-to-day system of borrowing from the general public, which has since proved very successful. Six weeks previously, namely, on 4th November, 1915, Mr. A. H. Gibson, a member of the British Association for the Advancement of Science, suggested in a letter to the Treasury that the Government should adopt a day-to-day system of borrowing, in a form that would attract subscriptions from the general public. In an article that appeared in the *Bankers' Magazine* for August, 1915, Mr. Gibson expressed his opinion that at least £100,000,000 a month could be attracted from the public under certain conditions.

Treasury Bills, or similar short-dated securities) being raised by H.M. Government for the purpose of carrying on the war, bonds of this issue would be accepted as the equivalent of cash to the amount of their face value for the purpose of subscription to any such loan, interest accrued to the date of the surrender of a bond to be paid in cash.

The issue of 5 per cent. Exchequer Bonds was entirely suspended after Friday, 20th October, 1916. A Post Office issue of the 6 per cent. bonds in denominations of £5, £20, and £50 became available on Monday, 16th October, 1916.

The object of the Government in raising the rate of interest on Exchequer Bonds was threefold: first, to quicken the inflow of loans of a comparatively short-dated character until a favourable opportunity presented itself for the issue of a long-dated spectacular loan; second, to stabilize the neutral exchanges by attracting foreign money; third, to endeavour to deflect new money from Treasury Bills into Exchequer Bonds, on account of the longer-dated character of the latter. To help the latter intention, Treasury Bill rates for six and twelve month maturities were reduced on Wednesday, 27th September, from 5¾ and 6 per cent. respectively to the uniform rate of 5½ per cent., the ruling rate for three-month maturities. For some time previous to the introduction of the new issue, sales of Exchequer Bonds had exhibited a tendency to decline. Exchequer receipts from this source of borrowing averaged only £4,383,000 per week for the quarter ending 30th September, 1916, as against £21,538,000 per week for the same period from increase in the amount of outstanding Treasury Bills, which, on 30th September, 1916, amounted to £1,041,488,000.

The introduction of 6 per cent. Exchequer Bonds occasioned a general chorus of criticism from all financial quarters. It was felt that the raising of the rate of interest was a mistaken policy. There was much resentment at the idea that British credit had depreciated to such an extent as to require the stimulus of a 6 per cent. rate of interest to support an adequate flow of new money. As was to be expected, the announcement of the new issue had an immediate and disastrous effect on the market value of all existing investment securities. According to the compilations of the *Bankers' Magazine*, the aggregate market value of 387 representative securities fell in the period 20th September–20th October, 1916, from

£2,896,390,000 to £2,831,082,000—a difference of £65,000,000. By 20th November, there was a further depreciation of £33,000,000; and by 18th December, a further depreciation of £39,000,000. For the month ending 20th September (before 6 per cent. Exchequer Bonds were issued) there had been a depreciation of only £2,106,000, and for the month ending 19th August an actual appreciation of £5,314,000.

Holders of the 4½ per cent. loan manifested considerable displeasure at the introduction of the 6 per cent. Exchequer Bonds. The new issue appeared to them to indicate the Treasury's intention to defer as long as possible the exercise of the option possessed by holders of the 4½ per cent. loan of converting into any future issues of a long-dated character. Between 27th September and 3rd October, the market price of the 4½ per cent. loan fell from £96 to £92½, and holders began to fear that their "conversion-rights" had no value. They were, however, to some extent reassured by a statement in the House of Commons by the Chancellor of the Exchequer to the effect that a long-dated loan would follow in due course, in which all undertakings to the holders of the 4½ per cent. loan would be amply fulfilled.

Possibly this much-criticized issue of 6 per cent. Exchequer Bonds was due to the fact that the Government of the day did not sufficiently realize that, as time goes on, the rate of interest, in itself, has less and less influence in attracting War Loans of sufficient amount, the main factors making for large aggregate subscriptions being widespread, continuous appeals to patriotism; every conceivable facility for the public making applications; popular forms of loans; and an occasional gentle hint, particularly to those quarters where resources available for loans are known to be large, that compulsory investment will be necessary if sufficient amounts of voluntary subscriptions are not continuously forthcoming. Some allowance should be made for the fact that a high rate of interest has some influence in encouraging people to save and in preventing extravagance and unnecessary consumption.

Treasury sales of 6 per cent. Exchequer Bonds were discontinued on Monday, 1st January, 1917, partly in view of the imminence of the issue of the long-promised new War Loan.

The following table shows the weekly Exchequer receipts from

sales of 6 per cent. bonds since they were first issued on 2nd October, 1916—

SIX PER CENT EXCHEQUER BONDS

(Repayable 16th February, 1920)

Week ending	Exchequer Receipts.
Oct. 7, 1916	20,621,000
„ 14, „	16,006,000
„ 21, „	13,279,000
„ 28, „	14,231,000
Nov. 4, „	12,479,000
„ 11, „	12,726,000
„ 18, „	12,508,000
„ 25, „	10,192,000
Dec. 2, „	12,212,000
„ 9, „	9,480,000
„ 16, „	10,025,000
„ 23, „	6,251,000
„ 30, „	9,194,000
Jan. 6, 1917	1,327,000
„ 7 to Feb. 17	420,700
Received later	48,865
Total Receipts	£161,000,565

The fact that the weekly receipts rapidly declined after a few weeks, proves that the rate of interest in itself was not sufficient to maintain the early rate of sales.

A prospectus of a new daily issue of 5 per cent. Exchequer Bonds was published on Friday, 13th April, 1917. Bonds of this issue are repayable at par on 1st April, 1922; but a holder, on giving three calendar months' notice in the prescribed form, might require repayment at par on 1st October, 1919. They were issued in denominations of £100, £200, £500, £1,000, and £5,000, as in the case of the earlier issues. It was stated in the prospectus that bonds of this issue would be accepted at their nominal value, with due allowance for any unpaid interest thereon, by the Commissioners of Inland Revenue in satisfaction of amounts due on account of Death Duties or of Excess Profits Duty, and by the Ministry of Munitions in satisfaction of amounts due on account of Munitions Exchequer Payments; provided, in the case of Death Duties, that such bonds have formed part of the estate of the deceased continuously up to the date of death from the date of the original subscription, or for a period of not less than six months

immediately preceding the date of death; and, in the case of Excess Profits Duty or Munitions Exchequer Payments,[1] that they have been held continuously by the firm, company, or other person, liable for such duty or payment, since the date of the original subscription or for a period of not less than six months before such duty or payment becomes due and payable.

A Post Office issue of the new 5 per cent. bonds commenced on Wednesday, 25th April, in denominations of £5, £20, and £50.

On 22nd September, 1917, it was announced that the existing issue of 5 per cent. Exchequer Bonds would be discontinued. Five days later, on 27th September, 1917, the Premier announced to bankers the terms of issue of a new class of bonds, to be known as National War Bonds, applications therefor to be received on and after 2nd October, 1917. This issue later became known as the first series. During the first three years of war, the Government had repeatedly urged upon it the desirability of changing the expression "Exchequer Bond" in future issues into one more likely to attract loans from the masses, and bearing some reference to the war. A second series of National War Bonds came on sale on and after 2nd April, 1918; a third series on and after 1st October, 1918; and a fourth and final series on and after 1st February, 1919, until withdrawn on 31st May, 1919, in view of the imminence of the Victory Loan. When a new series began, sales under the former series ceased henceforth. The different types of bonds issued in each series are shown below—

FIRST SERIES

5% Bonds	.	Repayable 1st October, 1922, at 102%;
5% Bonds	.	Repayable 1st October, 1924, at 103%;
5% Bonds	.	Repayable 1st October, 1927, at 105%;
4% Bonds[2]	.	Repayable 1st October, 1927, at 100%

Price of Issue, £100 per cent.

SECOND SERIES

5% Bonds	.	Repayable 1st April, 1923, at 102%;
5% Bonds	.	Repayable 1st April, 1925, at 103%;
5% Bonds	.	Repayable 1st April, 1928, at 105%;
4% Bonds[2]	.	Repayable 1st April, 1928, at 100%;

Price of Issue, £100 per cent.

[1] The Finance Act of May, 1917, merged the Munitions Levy into the Excess Profits Duty.

[2] Income Tax compounded.

THIRD SERIES

5% Bonds	Repayable 1st September, 1923, at 102%;
5% Bonds	Repayable 1st September, 1925, at 103%;
5% Bonds	Repayable 1st September, 1928, at 105%;
4% Bonds[1]	Repayable 1st September, 1928, at 100%.

Price of Issue: 5% bonds, £100 per cent.; 4% bonds, £101 10s. per cent.

FOURTH SERIES

5% Bonds	Repayable 1st February, 1924, at 102%;
5% Bonds	Repayable 1st February, 1929, at 105%;
4% Bonds[1]	Repayable 1st February, 1929, at 100%.

Price of Issue: 5% bonds, £100 per cent.; 4% bonds, £101 10s. per cent.

The bonds were issued in denominations of £50, £100, £200, £500, £1,000, and £5,000. Holders, according to the conditions laid down in the prospectuses, acquired the following important rights—

National War Bonds will be accepted at their nominal value, with due adjustment in respect of interest, by the Commissioners of Inland Revenue in satisfaction of amounts due on account of Death Duties, Excess Profits Duty, or Munitions Exchequer Payments, subject to certain conditions as to length of time of ownership.

Holders of the 5 per cent. bonds may, during certain periods in each year, convert their holdings into 5 per cent. War Loan, 1929–1947; and holders of the 4 per cent. bonds may convert their holdings into 4 per cent. War Loan, 1929–1942 (Income Tax compounded). This conversion right did not apply to the fourth series of bonds.

In the event of future issues (other than issues made abroad or issues of Exchequer Bonds, Treasury Bills, or similar short-dated securities) being made by the Government for the purpose of carrying on the war, National War Bonds will be accepted at par as the equivalent of cash for the purpose of subscriptions to such issues, and an allowance will be made for any interest accrued on bonds so accepted. This conversion right did not apply to the fourth series of bonds.

Provision was also made in the prospectus of the fourth series for the conversion of 4½ per cent. War Loan, 1925–1945; 5 per cent. Exchequer Bonds, 1919, 1920, 1921; and 6 per cent. Exchequer

[1] Income Tax compounded.

Bonds, 1920, into National War Bonds during the continuance of the issue of such bonds.

The various issues of National War Bonds were exceedingly successful, the total Exchequer receipts from this form of borrowing being £1,732,793,516.

It may be mentioned that, in order to stimulate the sale of National War Bonds, an arrangement was made at the end of May, 1918, by the Chancellor of the Exchequer with the banks whereby the latter agreed not to allow more than 3 per cent. interest to depositors. On 30th July, 1919, this agreement was cancelled.

Six months after the closing of the lists for applications to the Victory Loan, the Government announced, on 19th January, 1920, another issue of Exchequer Bonds, bearing interest from the date of purchase at 5¾ per cent. per annum, payable half-yearly, on 1st February and 1st August. The war with Germany having terminated, the new issue could not well be termed "National War Bonds." The proceeds of this loan were intended to meet about £200,000,000 Exchequer Bonds maturing during 1920. The new bonds, which were issued at par, are repayable on 1st February, 1925, but a holder may give notice during the month of January in either of the years 1921, 1922, or 1923 requiring repayment of the bonds at par on 1st February in the year next succeeding that in which such notice is given. Under no circumstances may notice once given be subsequently withdrawn.

Applications for the bonds had to be for the full amount, instalment payments not being accepted. They were issued in the denominations £50, £100, £200, £500, £1,000, and £5,000. The prospectus also stated that holders of 6 per cent. Exchequer Bonds due 16th February, 1920, 3 per cent. Exchequer Bonds due 24th March, 1920, and 5 per cent. Exchequer Bonds due 1st December, 1920, might surrender such holdings and receive in exchange therefor similar holdings of like amounts of bonds of the present issue. The application lists opened on 20th January. The list for conversion applications closed on 14th February, and for cash applications on 28th February, 1920.

On 24th February, 1920, the Chancellor of the Exchequer announced in the House of Commons the result (subject to correction when the final figures were available) of conversions

of maturing Exchequer Bonds into the new 5¾ per cent. issue. Conversion options were exercised in respect of £98,996,000 out of a total of £198,225,000 of the three issues maturing in 1920. Particulars with regard to the three issues were given as follows—

	Maturing Bonds.	Conversions.
	£	£
6% Bonds maturing 16th February—		
Bank of England[1]	121,592,000	59,974,000
Post Office	8,317,000	4,450,000
	129,909,000	64,424,000
3% Bonds, maturing 24th March—		
(No Post Office issue) . . .	21,540,000	13,174,000
5% Bonds, maturing 1st December—		
Bank of England[1]	37,376,000	17,818,000
Post Office	9,400,000	3,580,000
	46,776,000	21,398,000

[1] Including Bank of Ireland.

In answer to a question in the House of Commons on 3rd March, 1920, the Chancellor of the Exchequer stated that it was not yet possible to give exact figures for the cash subscriptions to the 5¾ per cent. Exchequer Bonds, but the amount exceeded £60,000,000, making with the conversions a total of not less than £160,000,000. These results were very much better than had been anticipated. Out of the total of £198,200,000 of Exchequer Bonds maturing during 1920, £138,500,000 had been provided towards the £156,400,000 maturities in February and March, and £21,500,000 towards the £46,800,000 maturity of 1st December.

Government returns later showed that the exact amount of the cash subscriptions to the 5¾ per cent. bonds was £67,215,784.

An entirely new class of bonds, known as 5–15 year Treasury Bonds, came on daily issue from 3rd May, 1920, in denominations of £50, £100, £200, £500, £1,000, and £5,000 (Post Office issue, £5, £20, and £50). In announcing the forthcoming new issue, the Chancellor of the Exchequer, in the House of Commons, on 28th April, 1920, made the following statement—

I have decided to offer for subscription on and after Monday next, 3rd May, a new Government bond. The terms of the issue will be as follows—

A five-fifteen year Treasury bond issue; price: par. Interest payable half-yearly on 1st May and 1st November. The bond will be repayable at par on 1st May, 1935, but there will be an option both to the Treasury and to the holder on giving one year's notice in April, 1924, or in any subsequent April up to and including April, 1933, to secure repayment at par on 1st May, 1925, or any subsequent 1st May up to and including 1st May, 1934.

The bond will carry interest at the minimum rate of 5 per cent. per annum, and will also carry additional interest payable during the period ending 1st May, 1925, as follows—

If and when during any half-year ended 1st May or 1st November, the Treasury bills issued to the public were sold to them at an average rate of discount exceeding 5½ per cent. and under 6½ per cent. per annum, then additional interest will be payable on the interest date next succeeding such 1st May or 1st November at the rate of 1 per cent. per annum.

If and when such average rate of discount on Treasury bills was 6½ per cent. per annum or over, then the additional interest will be at the rate of 2 per cent. per annum.

The first interest payment on 1st November, 1920, will represent interest from the date of purchase at the rate of 5 per cent. per annum plus additional interest at the rate of 2 per cent. per annum (i.e. 3½ per cent. for the half-year). The bonds will remain on issue till further notice. The entire proceeds of the issue will be applied to reduction of the floating debt.

The House will see that the arrangement in regard to interest is designed to protect the holder of the bond against capital depreciation when rates for short money are high, while at the same time the taxpayer is protected against the burden of paying a higher interest than 5 per cent. over a long period. This arrangement will also, it is hoped, prevent the new issue from causing further capital depreciation upon existing Government issues.

The above issue was withdrawn on 30th October, 1920, but a new issue, known as series B, and bearing the same conditions as the first, was offered to the public from 1st November, 1920. This second issue was withdrawn on 30th April, 1921, and was not replaced by any further series of the same class.

The actual Exchequer Receipts from issues of 5–15 year Treasury Bonds were £23,582,168 up to 28th May, 1921. This very poor response to the two issues may be attributed to three causes: first, want of fixity in the rate of interest; second, lack of sufficient advertisement and continuous Press appeals to subscribe; and third, lack of immediately available funds by the investing public. As pointed out elsewhere in this book, the issue of the great War Loans caused a large transference, after Government disbursements, of credit from deposit to current accounts at the banks. It will probably be several years yet before many of the investing class of depositors are able to build up their accounts again, and the banks experience the pre-war customary distribution of liabilities over deposit and current accounts.

TOTAL RECEIPTS FROM DAY-TO-DAY SYSTEM OF BORROWING (EXCLUSIVE OF TREASURY BILLS)

The total Exchequer receipts from daily sales of the various issues of Exchequer Bonds, National War Bonds, Treasury Bonds, and War and National Savings Certificates since the commencement of the recent war and up to 31st March, 1921, are shown in the following table—

From daily sales of	Exchequer Receipts up to 31st March, 1921.
	£
5 per cent. Exchequer Bonds, due 1919, 1920, 1921, 1922	416,862,065
6 per cent. Exchequer Bonds, due 1920	161,000,595
National War Bonds, due 1922, 1923, 1924, 1925, 1927 1928, 1929	1,732,793,516
5-15 year Treasury Bonds, due 1935[1]	22,584,233[2]
War and National Savings Certificates	339,140,794
	£2,672,381,173

[1] The only issue of bonds running on 31st March, 1921. It was withdrawn at the end of April. See particulars given in reference to issue for conditions for repayment prior to 1935.

[2] A further £997,935 was received on account of this issue between 1st April-28th May, 1921.

The Treasury has also received since the commencement of the war, £47,942,345 through sales (in March, 1915) of 3 per cent. Exchequer Bonds on the old system of tender, due 1920; £12,824,800 (in March, 1918) through 3 per cent. Exchequer Bonds, due 1930, issued in connection with obligation assumed by Government on account of Russian Treasury Bills and Commercial Credits, and £67,215,784 through 5¾ per cent. Exchequer Bonds, due 1925, issued during 20th January-28th February, 1920.

THREE AND A HALF PER CENT. CONVERSION LOAN OF 1921

The prospectus of this loan was issued on 26th April, 1921, and the application list closed a month later, on 28th May. The intention of the Chancellor of the Exchequer in connection with

this loan, which is only repayable at par on or after 1st April, 1961, at the option of the Government, was that it should replace £632,000,000 of National War Bonds which would mature for repayment between 1st October, 1922, and 1st September, 1925. The Chancellor saw no immediate opportunity of being able to fund the major part of the existing floating debt, and desired to avoid the danger of this debt being increased, or reduction prevented, by issues of Treasury Bills in the future to provide funds to meet bonds maturing within the period named.

The main features of the prospectus were as stated below—

Holders of 5 per cent. National War Bonds due on or before 1st September, 1925, may surrender their holdings for conversion as on the 1st April, 1921, and receive in exchange therefor holdings of £3 10s. per cent. Conversion Loan calculated as under—

£163	£3 10s. per cent. Conversion Loan in exchange for each £100 nominal of 5 per cent. National War Bonds	due 1st October, 1922
£162	,, ,, ,,	,, 1st April, 1923
	,, ,, ,,	,, 1st September, 1923
£161	,, ,, ,,	,, 1st February, 1924
	,, ,, ,,	,, 1st October, 1924
£160	,, ,, ,,	,, 1st April, 1925
	,, ,, ,,	,, 1st September, 1925

Holdings may be in the form of (1) Inscribed Stock "transferable in the Books"; (2) Registered Stock "transferable by Deed"; or (3) Bonds to Bearer in denominations of £50, £100, £200, £500, £1,000, and £5,000; and the several forms of holding will be interchangeable without payment of any fee. Stock will be transferable in sums which are even multiples of one penny.

Interest will be payable half-yearly, on the 1st April and 1st October, the first dividend, for a full half-year's interest, being payable on the 1st October, 1921.

The Loan will not be redeemable before the 1st April, 1961, but on and after that date may be redeemed at par on any half-yearly interest date at the option of the Government, on three months' notice being given in the *London Gazette*.

Commencing with the half-year ending 1st April, 1922, a sum equal to not less than 1 per cent. of the amount of the Loan outstanding at the close of any half-year during which the average daily price of the Loan, as certified by the Bank of England, has been below 90 will be set aside as a Sinking Fund to be employed during the succeeding half-year in the purchase of the Loan in the market for cancellation.

The result of the conversion offer was that holders of 5 per cent. National War Bonds of total face value of £163,328,133

accepted the offer of the Government and in exchange for their holdings received £264,889,112 of the 3½ per cent. Conversion Loan. This result was disappointing to the Government, but will undoubtedly, in the long run, prove a saving to the taxpayer. It was felt in financial quarters at the time the prospectus was issued that the terms of conversion were far too generous. Holders of the bonds to which the scheme applied would, by the act of conversion, receive a guaranteed rate of interest for 40 years equivalent to from £5 12s. to £5 14s. per annum on their holdings of National War Bonds (according to class). Judging from the rapid appreciation of Government credit after the termination of the Napoleonic Wars, to which reference is made in Chapter XIV, there will be a considerable fall in interest rates in the course of a few years. This fall will take place when production again tends to exceed consumption, at lower values than those ruling at present. If the whole of the bonds (£632,000,000) had been converted, the Conversion Loan amount would have slightly exceeded £1,000,000,000, and therefore have added about £370,000,000 to the National Debt.

As to the reasons why the response to the Government's excellent offer was so poor, there may be named: (1) Holders of National War Bonds did not fully understand the offer. Some may have thought they would lose 1½ per cent. in interest by the act of conversion, forgetting the more than compensating increase in the capital amount of their holdings. For this reason a greater response would probably have been made if the loan had been on a 5½ per cent. basis, the exchange being made par for par. (2) Doubt about the future course of interest rates. (3) Funds required for certain purposes about date of redemption of National War Bonds, holders thereof preferring not to risk by that date a fall in market value of the Conversion Loan, of which there appears to be no probability, particularly in view of the excellent Sinking Fund provision attached to the loan.

Another offer to holders of National War Bonds of early maturity (and which included holders of 5 per cent. Exchequer Bonds due 5th October, 1921), to convert their holdings into a longer dated loan was made by the Government in a prospectus dated 11th July, 1921, of a daily issue of 5½ per cent. Treasury Bonds to commence the following day. In announcing the forthcoming

issue to the House of Commons on 5th July, the Chancellor of the Exchequer stated that the sole purpose of the issue was to provide for redeeming maturing obligations, and thus to avoid undue recourse to Treasury Bills and Ways and Means Advances.

The main features of the terms of issue were as follows—

Price of issue, £97 per cent. Principal repayable at par on 1st April, 1929. Interest payable on 1st April and 1st October. Interest exempt from corporation profits tax. Bonds convertible at the holder's option as on 1st April, 1922, or 1st October, 1922, into 3½ per cent. Conversion Loan at the rate of £146 Conversion Loan for each £100 of bonds converted. Applications would be received on 12th July, 1921, and thereafter until further notice. On notice given not later than 26th July, 1921, holders of the following Exchequer and National War Bonds might surrender their holdings in whole or in part, and receive in exchange therefor similar holdings of like amounts of Treasury Bonds of the current issue, together with a cash payment as follows—

Five per cent. Exchequer Bonds, due 5th October, 1921, a cash payment of £4 per £100 of bonds surrendered.

Five per cent. National War Bonds, due 1st October, 1922, a cash payment of £4 per £100 of bonds surrendered.

Five per cent. National War Bonds, due 1st April, 1923, a cash payment of £3 10s. per £100 of bonds surrendered.

Five per cent. National War Bonds, due 1st September, 1923, a cash payment of £3 10s. per £100 of bonds surrendered.

All conversions would take place as on 26th July, 1921.

The current yield of the bonds at the price of issue is £5 13s. 3d., but on redemption averages £5 19s. 9d.

On 3rd August, 1921, the Chancellor of the Exchequer announced in the House of Commons that the total face value of Exchequer and National War Bonds converted into the new 5½ per cent. Treasury Bonds was approximately £89,000,000, of which about £52,000,000 represented Exchequer Bonds.

Borrowings Abroad

Since the commencement of the war the British Government borrowed from abroad, in round figures, £1,360,000,000, in the main from the United States of America. Two small loans were made by Japan and the Argentine, to which reference is made hereafter. The enormous purchases of foodstuffs and war materials made by the United Kingdom on behalf of herself and her Allies from the United States necessitated that the latter country must

make large loans to this country, otherwise the purchases must have inevitably had to be considerably reduced. The various ways in which the necessary loans were raised in America, and the part liquidation of indebtedness by sales of foreign and Colonial securities, are set forth in detail in the following pages. It is not possible to give the amount of gold exported from England to the United States during the war, but it is known that about £50,000,000 of gold was so exported during the year 1915.

Prior to the third year of war, apart from the establishment of credits in New York by the banks of the United Kingdom, the only loan arranged in the United States of America on behalf of the Government of Great Britain was the joint Anglo-French Loan for $500,000,000 (roughly, £100,000,000), issued during October, 1915, in the form of 5 per cent. bonds, free of all British and French taxes. The proceeds of the loan were divided equally between Great Britain and France. The bonds were jointly guaranteed by Great Britain and France, and no collateral security was required. They were made repayable at the end of five years, or convertible at the option of the holder into 4½ per cent. bonds of the British and French Governments, repayable not earlier than fifteen years and not later than twenty-five years from the date of the present loan. The bonds were issued to the American public at the price of 98, and, therefore, including redemption, yielded £5 9s. 3d. per cent. The whole issue was sold to an underwriting syndicate at the price of 96. Therefore, so far as the British and French Governments were concerned, the cost of the loan was equal to £5 18s. 10d. per cent. per annum.

Part of the above loan, it may be mentioned, was subscribed by the banks in the United States, and the remainder by the public. Part was, therefore, the loan of newly-created credit and part the loan of existing credit. It was recognized at a later stage that the most preferable method for part settlement by Great Britain of her large adverse trade balance was the selling outright of British holdings of foreign securities in the respective countries for English account; for the greater the amount of gold sent to, or temporary credits raised in, the United States, the greater the inflation of prices in that country, and, consequently, the creation of a vicious circle against Great Britain reflected in higher prices for necessary imports from the United States. (The stock of

gold coin and bullion in the United States was estimated at \$1,872,000,000 on 30th June, 1914, at \$3,019,000,000 on 30th June, 1917, and at \$3,223,000,000 on 30th June, 1921.)

The loan was duly repaid by the British and French Governments on 15th October, 1920. Preparations for repayment had been made for some weeks previously, and, naturally, the liquidation of such indebtedness had some effect on the New York exchange. Great Britain's share of the loan was \$250,000,000, as already stated, and to provide this amount in dollars at the ruling rates of exchange cost the Treasury £59,229,221. It was estimated in well-informed quarters in New York that, prior to the date of redemption, about \$300,000,000 of the bonds had already been purchased by the British and French Governments in the open market, principally by Great Britain. Of the French share of the maturity, \$100,000,000 was provided for by a recent new French loan in New York. The balance was met by gold and purchases of New York Exchange.

During the month of August, 1916, the first tangible results of the scheme for mobilization of foreign securities held in this country (scheme discussed later in Chapter) was seen by arrangements being made in the United States of America for a loan to the United Kingdom of \$250,000,000 (roughly, £50,000,000) for two years at 5 per cent. per annum, free of all British taxes, which was underwritten at 98 and offered to the public at 99, and based on Canadian, United States, and other foreign securities as collateral. The loan was dated 1st September, 1916, and matured 1st September, 1918. The British Government had reserved the option of redeeming the loan, in whole or in part, subject to thirty days' notice, on any day up to 31st August, 1917, at 101 and accrued interest, and on any day thereafter up to 31st August, 1918, at 100½ and accrued interest.

Towards the end of October, 1916, details became available of a further loan which was being arranged in America on behalf of the United Kingdom for \$300,000,000 (roughly, £60,000,000), based on Canadian, United States, and other Colonial and foreign securities as collateral, including a relatively small amount of obligations of British railway companies. One half of this loan was in the form of 5½ per cent. three-year notes dated 1st November, 1916, maturing 1st November, 1919, and issued at 99¼; and the

other half in the form of 5½ per cent. five-year notes dated 1st November, 1916, maturing 1st November, 1921, and issued at 98½—in each case the interest being free of all British taxes. Each maturity was subject to redemption, in whole or in part, at the option of the British Government, at a premium of 1 per cent. for each year (or any part) of unexpired life of such maturity. The sale of the notes was underwritten by a powerful syndicate in America at 1½ per cent. below the average offering price.

Towards the end of 1916 there was an increasing recognition in America of the dangers likely to arise from inflation following a continuance of the excessive gold imports into that country. Bankers adopted the view that it was preferable to grant credits to and arrange loans for the Allies rather than to receive too great a quantity of gold, with its influence in stimulating inflation of every kind. Since the outbreak of war and up to the end of 1916 America had received at least $900,000,000 (roughly, £180,000,000) in gold in part payment of her extremely favourable trade balance. Obviously, this exceptional addition to her gold stocks was undesirable, for as a basis for the expansion of credit it constituted a potential danger.

It is interesting to observe that the great imports of gold during 1916 did not stay in New York during that year, but flowed to the interior banks as a consequence of intensely active and profitable interior trade, following on Europe's enormous purchases of grain, metals, and finished munitions produced in the nearer or further West. Part of the gold went to increase Western and Southern Bank Reserves, and part was drawn into active circulation as a consequence of high wages and of the abnormally high prices prevalent for commodities.

The opinions of American bankers as to the advisability of granting further loans to the Allies, and the dangers of inflation likely to ensue from a continuance of excessive gold imports, were not altogether supported by the Federal Reserve Board of the United States, which, on Tuesday, 28th November, 1916, issued a circular to the banking community containing, among other warnings, a caution against locking up their funds in long-term obligations of foreign Governments, or in investments which were short-term in form or name, but which, either by contract or through force of circumstances, might in the aggregate have to be

renewed until the return of normal conditions. A special warning was issued to the member banks against investing in foreign Treasury Bills, on the ground that the borrower must attempt to renew them collectively until such time as it was advantageous to convert them into a long-term obligation. The Board did not subscribe to the freely expressed opinion in America that further importations of large amounts of gold must of necessity prove a source of danger or disturbance to that country. That danger (the circular stated) will arise only in case the inflowing gold should remain uncontrolled, and be permitted to become the basis of undesirable loan expansion and of inflation. The Board considered that there were means of controlling accessions of gold by proper and voluntary co-operation of the banks, or, if need be, by legislative enactment.

The action of the Federal Reserve Board in issuing a warning circular to banks immediately followed proposals under consideration in America for the issue in that country of British short-term Treasury Bills. Later, when it became apparent that war between the United States of America and Germany could not be long delayed, the Federal Reserve Board changed its policy and commended to American bankers the merits of foreign loans.

An interesting loan, which put the British Government in possession of, roughly, \$50,000,000 in the United States, was arranged early in December, 1916. Japan at this time being in possession of large dollar credit balances in the United States, the British Government raised a loan in Japan for the equivalent of £10,000,000 at 6 per cent. per annum for a period of three years, and, by an exchange operation, devoted the proceeds of the loan to purchasing dollars in America held on Japanese account.

On Thursday, 18th January, 1917, announcement was made of a new British loan to be issued in America for \$250,000,000 (roughly, £50,000,000) at 5½ per cent. per annum interest, based on Canadian, United States, and other Colonial and foreign securities as collateral, including a small amount of British railway securities. The loan was divided into two parts: \$100,000,000 in the form of one-year notes, due 1st February, 1918, and issued at 99·52; and \$150,000,000 in the form of two-year notes due 1st February, 1919, and issued at 99·07—the yield in each case being, therefore, 6 per cent. The issue, the lists of which were open from 24th

January to 31st January, was made under the auspices of a very strong body of American bankers. Interest was payable free of all British taxes. The notes were convertible upon notice, at the option of the holder, at any time before maturity, or (if called for earlier redemption) at any time up to the date of such redemption, into twenty-year 5½ per cent. bonds of the United Kingdom, payable 1st February, 1937, and not subject to prior redemption. The British Government reserved the option of redeeming the notes, in whole or in part, on 30 days' notice, on the following terms : One-year notes at 101 plus interest ; two-year notes at 102 plus interest up to 1st February, 1918, and at 101 plus interest between 1st February, 1918, and 1st February, 1919.

The British loan raised in the United States at the end of January, 1917, marked the last of a series of loans raised in America by the United Kingdom during the period of American neutrality. The series are listed in the following table—

BRITISH LOANS RAISED IN UNITED STATES OF AMERICA SINCE THE COMMENCEMENT OF THE WAR UP TO APRIL, 1917

Nature of Loan.	Amount.	When Issued.	Rate of Interest.	Issue Price.	Date of Maturity.
	Dollars.				
British portion of Anglo-French Loan (no collateral) .	250,000,000	Oct., 1915	5	98	Oct. 15, 1920[1]
Two-year Coll.Notes	250,000,000	Sept. 1916	5	99	Sept. 1, 1918
Three-year ,, ,,	150,000,000	Oct., 1916	5½	99¼	Nov. 1, 1919
Five-year ,, ,,	150,000,000	Oct., 1916	5½	98½	Nov. 1, 1921
One-year ,, ,,	100,000,000	Jan., 1917	5½	99½	Feb. 1, 1918[2]
Two-year ,, ,,	150,000,000	Jan., 1917	5½	99	Feb. 1, 1919[2]
	1,050,000,000				

(The above table is exclusive of various temporary loans raised in America.)

[1] Convertible at option of holder into 4½% bonds, repayable not earlier than 15 years and not later than 25 years from original date of loan.
[2] Convertible at option of holder into 5½% bonds, maturing in 20 years.

So far as Allied payments in America were concerned, an entirely new set of financial conditions arose soon after the entry (on 5th April, 1917) of America into the war on the side of the Allies.

On 14th April, the House of Representatives passed a War Finance Bill for $7,000,000,000, of which $5,000,000,000 was to be issued in the form of long-term bonds. Of the latter sum, $3,000,000,000 was to be available for loans to the Allies; and the remaining $2,000,000,000 to be issued in the form of Treasury certificates maturing within twelve months. The first issue of the United States Liberty Loan was made early in May. It was for $2,000,000,000 at 3½ per cent., tax free, and was greatly over-subscribed, the total applied for being $3,035,226,850 (roughly, £607,045,000). The War Finance Act stated no exact dates for repayment by the Allies of loans made to them, but stipulated that the loans should bear the same rate of interest as the American bonds issued to raise the necessary funds; and should also contain the same terms and conditions. Henceforth, the Allies had not to deposit various securities as collateral to loans, as in the case of previous loans. They had only to deposit their own Government bonds with the Treasury of the United States. After the proceeds of the Liberty Loan had become exhausted, the United States Government found it necessary to raise several other loans in her own country, to pay for her own war expenditure and to permit of further loans to her Allies.

Great Britain received her first loan from America under the new arrangements on 25th April, 1917, the amount being $200,000,000, the rate of interest payable being 3 per cent. per annum until 30th June, 1917, and thereafter 3½ per cent. until such time as America might have to pay a higher rate to her own bondholders. At an exchange rate of 4·76½, the sterling equivalent of the loan is £41,972,718, this being the actual amount that appeared under the heading "Other Debt created under the War Loan Acts, 1914 to 1916" in the British Exchequer Accounts for the week ending 5th May, 1917. Up to 4th August, 1917, the end of the third year of war, the advances made by the American Government to the British Treasury amounted to $955,000,000 (roughly, £191,000,000, taking $5 to £1). Up to 15th November, 1919, the total of such advances amounted to $4,220,000,000 (roughly, £844,000,000, taking $5 to £1). Practically the whole of this amount was applied to financing supplies of foodstuffs and raw materials required by Great Britain from the United States.

The following table shows the total advances made by the

United States Government to her Allies up to 15th November, 1919, the figures being extracted from the Annual Report of the United States Treasury—

	$
United Kingdom	4,220,000,000
Russia	188,000,000
France	2,985,000,000
Italy	1,611,000,000
Belgium	339,000,000
Serbia	27,000,000
Other Allies	136,000,000
	9,506,000,000 [1]

The advances were made against demand obligations bearing interest corresponding to the American loans from which they were provided.

In what form and within what period the United States will eventually receive repayment of the loans made by her to her Allies it is impossible to foretell. At a meeting of representatives of the Allies (at which representatives of the United States were not present) held at Brussels early in July, 1920, a proposal was made that the United States should agree to pool the war debts of the Allies and Associated Powers. The total amount actually lent by the United States Government to the Allies was then stated to be £1,931,876,929. It was recognized that any pooling arrangement would involve some scaling of this debt, but it was considered that the loss to the United States would be more than compensated by the improvement in the economic situation generally. If, instead of scaling the debt, it were included in an international loan, covering both the German indemnity and the refunding of all the Allied war debts, and on which America's guarantee would be added to that of the Allies and of Germany, it was felt there would be a sensible easing of the economic and financial situation all round.

On 12th January, 1918, an announcement was made to the effect that an agreement had been concluded with the Argentine for a credit of £40,000,000 to Great Britain and France.

An announcement was made on 21st October, 1919, of the issue in New York of a British Government loan of $250,000,000 at 5½ per cent. The loan was for three and ten years. The three-year

[1] Including accrued interest and other items, the total of Allies' Debts to U.S. Government on 31st March, 1921, was $10,959,000,000.

notes were issued at 98 and the ten-year notes at 96½. The proceeds were partly applied to take up the 5½ per cent. British Government notes maturing on 1st November, 1919.

One form of borrowing from the United States to which reference has not yet been made was the placing on the New York money market since 24th August, 1917, of a weekly quota of $15,000,000 ninety-day British Treasury Bills. An increasing number of New York institutions accustomed themselves to taking a regular amount of these bills each month to replace maturities. The maximum amount of such bills outstanding at any moment in the United States was $98,005,000 on 30th September, 1919. The total, which varied from day to day, had been reduced to $31,540,000 by 8th November, 1920.

The total external debt of the United Kingdom at 31st March, 1921, was £1,161,563,000, as against £1,278,714,000 a year previously, at 31st March, 1920, a reduction of £117,151,000 having been effected in the course of twelve months.

Mobilization of Securities[1]

Towards the end of the year 1915 it became evident that if the British Government was to meet increasing indebtedness to the United States, created by very large purchases of foodstuffs and munitions of war in that country, some other scheme than sending gold would have to be devised, for there were limitations to depleting the stock of gold in the United Kingdom. The remedy was ultimately found in the scheme known as "Mobilization of Securities." By this scheme the Government acquired or borrowed for a period certain foreign and Colonial securities held in this country. Some of the securities purchased by the Government were later sold outright in America ; others were used as collateral for loans raised in America on account of the United Kingdom. During the third year of war the scheme for the mobilization of securities underwent considerable modification and enlargement, particularly in its later stages by the introduction of the element of compulsion.

[1] This scheme closely followed suggestions sent to the Treasury by Mr. A. H. Gibson (a member of the British Association for the Advancement of Science) in letters dated 5th July, 1915, and 16th November, 1915, even to the extent of the 10s. per cent. per annum paid as consideration to lenders.

Indebtedness had not only to be liquidated in America, but in other neutral countries, though in the latter case to a much smaller extent. The following is a summary of the scheme for the mobilization of securities since its inauguration—

Scheme A.—The Chancellor of the Exchequer stated in the House of Commons on 13th December, 1915, that the Government were desirous of purchasing outright or borrowing certain American and Canadian dollar securities held by holders in this country, in order to use such securities for the purpose of steadying the American Exchange. Preferably, holders of selected securities were invited to sell such securities to the Treasury at the current market price, the purchase money to be paid in five-year 5 per cent. Exchequer Bonds at par. Alternatively, holders who did not wish to sell outright were invited to pledge selected securities with the Treasury for a period of two years from the date of transfer, the lender to receive all interest and dividends paid in respect of them, and also, by way of consideration for the loan, a commission at the rate of 10s. per cent. per annum on the face value of the securities. The Government reserved the right to sell borrowed securities under certain conditions. This reservation did not meet with the approval of holders. The lender, however, had also the right to sell the whole, or a portion, of the securities deposited under the scheme, receiving the amount realized in sterling or the equivalent in sterling of the dollar proceeds. The Treasury later undertook, when deciding to dispose of securities, to notify the lender, and to grant him fourteen days in which to buy the securities back by paying the market price in dollars. Holders of required securities were later coerced into selling or lending them to the Treasury by a penal additional Income Tax of 2s. in the £ on income derived from such securities.

Scheme B.—At the commencement of the third year of war, a second plan, designated Scheme B, was instituted in connection with the mobilization of securities. This scheme aimed not at the purchase of securities by the Government, but the borrowing of them from the public for five years, with the right to repay earlier. The Treasury announced on 12th August, 1916, that as from 14th August, 1916, they would be prepared to accept various specified securities upon deposit on certain terms and conditions. The securities specified were certain Argentine Government bonds and

railway stocks; Brazilian Funding Bonds (1898); various Canadian Government and railway securities ; and certain Egyptian, Scandinavian, Japanese, Dutch, and Swiss Government and municipal bonds. Further lists of required securities were published later. The main conditions attaching to Scheme B were as follows : The securities were to be transferred to the Treasury for a period to expire at the end of five years from 31st March, 1917, subject to the right of the Treasury to return them to the holders at any time on or after 31st March, 1919, on giving three months' notice. While the securities were on deposit with the Treasury, the lender was to receive all interest and dividends paid in respect of them, and also, by way of consideration for the loan, a payment at the rate of 10s. per cent. per annum, calculated on the face value of the securities. The Treasury reserved the right at any time during the currency of the loan to dispose of the securities should they find it necessary to do so ; but in the event of their being so disposed of, the lender was to continue to receive from the Treasury the same payments as he would have received if the securities had been retained ; and at the end of the period of the loan, the Treasury would either return to the lender securities of the same description and to the same nominal amount as those originally deposited, or, at its option, pay to him the deposit value of the securities, with an addition of 5 per cent. on that value, plus accrued interest from the last preceding interest date. On Tuesday, 15th August, 1916, it was announced that should the Treasury be under the necessity of exercising its right to sell any of the deposited securities (a very remote possibility)—and the average price realized was more than the deposit value plus 5 per cent.—the depositor would, if the securities were not replaced, at the end of the loan period receive the full amount of the average price actually realized. The deposit value of all securities specified in the list of 12th August, 1916, was stated to be the net mean quotation (less accrued interest when it was included in the price) on the London Stock Exchange on Friday, 11th August, 1916 ; and in the event of other securities being later specified, the net mean quotation on the day preceding the notice of their inclusion in the scheme. The official notice of 12th August, 1916, also announced that holders of American dollar securities who had already deposited them with the Treasury under Scheme A (deposit on loan for two years) might transfer

their deposit to Scheme B by giving notice, not later than 14th September, 1916, of their desire to do so. Arrangements were made with the Stock Exchange Committee for dealings on the Stock Exchange in the deposit certificates issued in return for securities deposited under Scheme B.

The reservation by the Treasury of the right to sell deposited securities occasioned some misconception at the introduction of Scheme B. The intention of the Government was to use the deposited securities as collateral for loans raised abroad. A definite statement was made by the Chancellor of the Exchequer in the House of Commons on 23rd August, 1916, to the effect that deposited securities would not be sold except in the extremely remote contingency of default on the part of the British Government on its own loan.

At first, Scheme B was purely voluntary; but eventually the penal additional Income Tax of 2s. in the £, alluded to in Scheme A, was extended to cover securities which the Treasury was prepared to borrow under Scheme B.

A second list of securities needed by the Treasury under Scheme B was issued on 24th August, 1916, and further lists followed at later dates.

On Saturday, 16th December, 1916, it was announced that Scheme A was withdrawn, and depositors were invited to transfer their deposits thereunder to Scheme B. The power of sale possessed by depositors under Scheme A was extended to Scheme B, in respect of all securities subject to the penal Income Tax, to any securities which the Treasury might wish to purchase, and to those the principal and interest of which were repayable in United States dollars.

Scheme for Conscription.—A special Supplement to the *London Gazette*, published on Thursday, 25th January, 1917, applied the Defence of the Realm Regulations to certain classes of securities which the Treasury were of opinion that, for the purpose of strengthening the financial position of the country, it was expedient to do so. The Treasury were thereby given the right to requisition or conscript securities, and to require from all holders of certain classes of securities full returns of their holdings, both in the United Kingdom and abroad. Compensation for securities requisitioned was granted on the same principle which had been applied in

fixing the price for securities voluntarily sold to the Treasury, that is to say, where entire ownership was required by the Treasury, the capital value of the securities, based on current market prices, was to be paid. Where temporary use of securities only was desired, the remuneration was to be as before, 10s. per cent. per annum on the face value. If full ownership was subsequently required of securities taken in the first instance for temporary use, the compensation payable when full ownership was taken was to be based on the capital value at the date of original requisition, or at the date of taking over full ownership, whichever might be higher, but no additional allowance was to be granted such as that provided for under the purchase clause of the voluntary deposit scheme. Securities were still to be received on deposit under Scheme B, but only on the understanding that if they were subsequently included in a Treasury order they should then be dealt with under the order, without regard to the fact that they had been already deposited. Securities coming within the scope of the regulations might still be sold, always provided that at the time of sale they had not been included in any Treasury order, and the observance of certain conditions of sale.

Four long lists of securities requisitioned under the Defence of the Realm Regulations were issued by the Treasury, the last being dated 7th May, 1917.

The entry of the United States of America into the war on the side of the Allies at the commencement of April, 1917, and the subsequent granting of loans (from 25th April) by the United States Government to the Allied Governments, rendered unnecessary any further deposit of securities as collateral for new loans raised in America by the British Government.

About the middle of May, 1917, the Treasury announced that, until further notice, no more securities would be accepted for deposit under Scheme B, except securities which were subject to the special Income Tax of 2s. in the £, but which had not yet appeared in any requisition order under the Defence of the Realm Regulations. Notwithstanding part closure of the deposit scheme, the Treasury were still desirous of purchasing outright American and Canadian Dollar Securities suitable for sale in the United States of America.

Scheme B was closed on 1st March, 1918, but securities subject to the additional Income Tax of 2s. in the £, and which had not

appeared in any of the requisition orders, were still accepted on loan for a period to expire on 31st March, 1922, under the terms and conditions of Scheme A, subject to return at any time on the Treasury giving three months' notice. The additional special Income Tax of 2s. in the £ was discontinued from 6th April, 1919, and the purchase by the Treasury of deposited securities was discontinued from 28th April, 1919.

In the middle of April, 1920, and again at the commencement of May, 1920, the Treasury announced that it was prepared to purchase certain securities which had been deposited on loan.

On 10th November, 1920, the National Debt Office announced that until further notice the Treasury would, on application, release securities in New York, previously deposited by the lenders under Scheme B, without requiring the depositor to provide the equivalent value in dollars in New York. Up to this date, holders of deposited securities who wished to sell in New York were required to pay dollars to the account of the Treasury there, receiving the equivalent amount in sterling. Several announcements had been previously made to the effect that the Treasury had decided to exercise its option to return to holders certain shares and bonds.

In a Parliamentary answer about the middle of March, 1921, the Chancellor of the Exchequer gave the following particulars as to the amount of securities deposited with the Treasury and the amount sold or returned to holders—

The nominal amount of securities originally deposited was: Sterling securities, £307,607,063; Dollar securities, £648,314,720; Other currencies, £21,096,800. Of these, there have been sold or released under the terms of the scheme: £31,090,803, £293,598,367, £14,105,200; and returned (or under notice of return): £165,381,365, £211,239,708, £6,991,600. There remain: Pledged and subrogated, £93,215,034, £96,529,910; Free, £17,919,863 £46,946,735. (No securities remained of "Other Currencies.")

Three months' notice of return of securities has to be given. Free securities consist mainly of portions of blocks of bearer securities the balance of which is pledged, and these can only be conveniently released when the whole block can be freed for return. Every effort is being made to return these securities as fast as possible, and further deposits will be available for return shortly, which will reduce the free securities to £6,028,790 and £37,600,710.

The annual charge for the additional allowance of ½ per cent. was £1,800,000 in 1919-20; will be less than £1,500,000 in 1920-21; and should be extinguished by 31st March, 1922.

American Dollar Securities Committee

This Committee was appointed by the Chancellor of the Exchequer at the end of December, 1915, "to control the operations of the

Treasury undertaken for the purpose of carrying into effect the Government Scheme for the sale to, and deposit with, the Treasury of American Dollar Securities."

Early in December, 1919, the American Dollar Securities Committee issued a very interesting report containing a review of their operations in connection with the securities that had been loaned to or purchased by the Government under the mobilization of securities scheme. In this report, the Committee stated that their functions were to control the operations initiated at the Treasury for the purpose of improving and maintaining the American Rate of Exchange, which had been gradually falling since the commencement of the war, as a result of the large purchases of munitions and other goods.

The following are extracts from the report of this Committee—

Immediately preceding the declaration of war, the cable rate in New York was abnormally high, being marked at $7 to the £ on the 1st August, 1914, although it is doubtful if much business was done above $5 to the £. The rate gradually fell until the end of the year, when it was quoted at 4·86⅛. In 1915 the rate still continued to fall until July, when the quotation was 4·77. In July, 1915, the Treasury took the first step with the view of helping the exchange by instructing the Bank of England to purchase American Dollar Securities in London and transmit them to New York for sale; and these operations were continued until the close of the year, by which time securities of the nominal amount of $233,000,000 had been purchased. In the meantime, the exchange had fluctuated between the rate of $4·77 and $4·51, with an upward tendency from the end of October. On the 15th December, 1915, a circular letter to insurance and trust companies was issued by the Treasury requesting them to submit lists of American Dollar Securities which they were willing to sell or deposit on loan with the Treasury, and on 31st December a corresponding circular was issued to the general public.

A scheme setting forth the conditions under which the securities would be (1) purchased, or (2) accepted on loan (subsequently known as Scheme A), was published in the *London Gazette* of the 17th December, 1915, and, as this scheme formed the basis of the operations of the Committee, the salient terms may be mentioned.

(1) *Purchase.*—The Treasury undertook to purchase any suitable

Dollar Securities, at prices based on current New York Stock Exchange quotations, the sterling price to be paid being calculated at the exchange of the day; in the case of no reliable quotations being available the price was to be fixed by agreement.

Exchequer 5 per cent. Bonds maturing in 1920, available for subscription to any future long dated War Loan at face value, plus accrued interest, could be taken at the seller's option in lieu of cash.

(2) *Deposit on Loan.*—Securities loaned to the Treasury were to be accepted for two years from the date of deposit, on the understanding that the interest received on such securities would be paid to the depositor together with an additional payment at the rate of one-half of 1 per cent. per annum on the nominal amount of the security. The securities would be inscribed in a Treasury Register and transferable by deed, but so as not to involve the depositor in any additional expenditure for stamps or fees; and Treasury Certificates negotiable on the London market would be issued for each deposited security. Depositors had the option to release securities so deposited by payment of the dollar value in New York, or they could be sold on behalf of the depositor, the understanding in each case being that the equivalent value in sterling at the exchange of the day should be paid in London.

In January, 1916, the Committee commenced operations by the issue of a selected list of 54 American Dollar Securities, the respective quotations being based on the current New York price specially sent by cable the previous night.

On the first day, securities to the value of as much as £450,000 were obtained, and the figures were rapidly increased as the scheme became more widely known—in fact, the business was such that it was found desirable to have special contract notes printed, which provided for the purchase money being paid in Exchequer Bonds as well as in cash, and for the physical possession certificate required to exclude enemy securities.

Additional lists of suitable bonds and shares were published from time to time, and by this means the Treasury had, by 17th March, 1916, offered to purchase at the officially quoted prices no less than 256 selected securities. Furthermore, very large blocks, not necessarily limited to the investments quoted in these lists, were purchased from various insurance companies, banks, etc., at agreed figures, and in this connection the preliminary information supplied

on the forms, to which reference has previously been made, was found most useful. The value of securities so obtained by that date was £40,500,000.

So far the operations of the Committee had been limited to the purchase of securities for sale in America, but the requirements of the Government necessitated increased support, and the Treasury, on the 24th March, 1916, decided that deposit on loan of securities should be commenced. Preparations for this extension of the Committee's operations had been made beforehand ; a booklet containing a list of 778 securities suitable for deposit was issued, together with a set of working regulations and a copy of the Scheme as published in the *London Gazette* on the same day. The minimum amount of any one security acceptable for deposit was fixed at $5,000 (£1,000).

On the 16th May a booklet of 909 securities which the Treasury would purchase or accept on loan was published. During the period from the 17th March, the amount paid for securities bought was £8,500,000, and the nominal amount of securities deposited on loan $40,300,000. As these figures were below the amounts required, and since some hesitation to comply with the Treasury wishes was evident, the Chancellor of the Exchequer issued a special request for increased support on the 27th May, 1916, and, on the 29th May, a resolution of the House of Commons provided for an additional Income Tax of 2s. in the £ on such securities as the Treasury, by means of special lists, declared its willingness to purchase. This resolution was embodied in Section 27 of the Finance Act, 1916, 6 & 7 Geo. 5, cap. 24, which imposed the tax on securities to be specified, which were not placed at the absolute disposal of the Treasury by either sale or deposit.

The effect of the resolution was immediately evidenced by a large increase in both the sales and the deposits. The first special list was published in the 5th Supplement to the *London Gazette* of the 5th June, 1916, and was followed at intervals during the year by five other lists.

At the 12th August, 1916, the total amount of the purchases was £109,228,000, and of deposits £83,614,000, making in all £192,842,000.

On the 16th June, 1916, the Deposit Scheme was extended so as to include securities of less nominal amount than $5,000. These small holdings of securities were to be deposited through approved agents, such as bankers and stockbrokers, by whom the offers were

to be aggregated and deposited with the Treasury in the name of the agent. 283 agents were appointed, the arrangement being that they should practically keep a sub-register and undertake the distribution of the interest and additional allowances as they fell due.

In July, 1916, the Treasury made a special bid for certain securities of the Provinces of Manitoba and Saskatchewan, and in August for City of Winnipeg 4 per cent. Consolidated Stock, 1940–1960.

On the 12th August, 1916, a new scheme for loan of securities to the Treasury (known as Scheme B) was promulgated. The terms of this scheme were in most respects similar to those of Scheme A, except that (1) the duration of the deposit was fixed at five years from 31st March, 1917, subject to the right of the Treasury to return the securities at any time after 31st March, 1919, on giving three months' notice ; and (2) the Treasury reserved the right of disposing of the securities if necessary, continuing the payment of interest and additional payment until the end of the period of loan, when similar securities would be returned, or, failing such return, the Treasury undertook to pay the depositors the deposit value of the securities with an addition of 5 per cent. on that value, or the price realized, whichever was the greater. The deposit value was defined in the scheme.

Depositors under Scheme A were given the option to transfer to Scheme B, and advantage was taken of this offer to the extent of 57½ millions out of a total of 82½ millions. The offer was withdrawn on 4th September, 1917.

All securities which were acceptable on loan under Scheme A were also acceptable under Scheme B, and, in addition, certain other securities were included, chiefly foreign and Colonial Railway and Government Securities having a ready market in the United Kingdom.

The Registered Canadian and South American Railway Stocks were freely offered and aggregated about £173,000,000. An advantageous and economical arrangement was made with the respective railway companies, by which they undertook to keep the Treasury Register and to pay the dividends as they fell due.

By this arrangement the National Debt Commissioners were relieved of the preparation and despatch each year of dividend warrants to the number of 350,000, but in order to be prepared for

any untoward circumstances a duplicate of the Register was set up. The Treasury Certificates, numbering 162,000, were prepared in, and issued by, the Department.

Bearer securities with coupons payable in London were also lodged freely, and aggregated £112,000,000 ; in this instance a special arrangement was made with the paying agents by which they undertook to pay the coupons plus the additional allowance for a limited time, on being supplied with schedules in duplicate, in such form as would permit of the calculations being completed. The arrangement lasted until the 30th September, 1917, when the whole of the work was taken over by the National Debt Office.

In October, 1916, Messrs. J. P. Morgan & Co. notified the Treasury that it would be desirable to include in the collateral for a forthcoming loan in the U.S.A. a certain amount of British Railway Debenture Stocks. As only a limited sum was required it was decided to issue a private invitation to a few large holders, mainly insurance companies, to deposit their stock. The terms varied from those of Scheme B in so far as the additional interest allowed was 10 per cent. of the annual rate instead of ½ per cent. on the nominal amount of stock, but depositors were guaranteed that, should any further scheme for borrowing securities be introduced, they would be given the advantage of any improved conditions or remuneration. The nominal amount of the stocks obtained by this method approximated to £17,500,000.

The aggregate amount of the purchases and deposits to the 31st December, 1916, were £118,269,000 and £347,524,000 respectively.

On the 24th January, 1917, the Defence of the Realm (Securities) Regulations, Nos. *7c*, *7d*, and *7e*, came into force, which gave the Treasury power to acquire securities, and placed restrictions on the disposal of same. While securities continued to be received on deposit, such securities were to be subject to any orders that might be issued by the Treasury under the Regulations. The Treasury Notice under these Regulations, dated 30th January, 1917, stated the conditions under which securities could be sold abroad, and placed upon the American Dollar Securities Committee the duty of issuing the necessary permits.

On the 17th February, 1917, the Treasury issued the first order under the Defence of the Realm (Securities) Regulations, applying the provisions of Regulation *7c* to certain specified securities, and

requiring the owners or custodians of such securities and other persons interested in them to take effective steps to deliver the securities to the American Dollar Securities Committee on or before the 17th March, 1917, at the prices specified against the several securities.

Three additional orders were made by the Treasury, the last being dated the 7th May, 1917.

On the 11th May, 1917, the acceptance of securities on deposit was discontinued, except as regards such securities as were subject to the additional Income Tax of 2s. in the £, but the purchase of securities was retained.

Scheme B was closed on the 1st March, 1918, but securities subject to the additional Income Tax of 2s. in the £, and which had not appeared in any of the requisition orders, were still accepted on loan for a period to expire on the 31st March, 1922, under the terms and conditions of Scheme A, subject to return at any time on the Treasury giving three months' notice.

The securities loaned under Scheme A for a period of two years from the date of deposit commenced to fall due for return to the depositors in March, 1918, and it was deemed desirable to offer to extend the term so as to provide for the return of securities terminating at the same time as those deposited under Scheme B. The majority of depositors accepted the offer, securities to the nominal value of only $476,270 being returned at the original maturing dates.

On the 2nd January, 1919, the prohibition on the sale of securities abroad without the permit of the American Dollar Securities Committee was removed, and the functions of the Committee were reduced to granting permits for the import of securities sent abroad for registration. On the same date the purchase operations were limited to the requisitioned securities and the securities that had been deposited on loan ; and the purchase of the latter was discontinued on 28th April, 1919.

It is a satisfaction to the Committee to be able to state that notwithstanding the immense number and variety of securities loaned to the Treasury, not a single instance has occurred of a security being lost.

The following table shows the totals of the several currencies of the securities acquired by the Treasury up to 31st March, 1919

for the purpose of maintaining the exchange in New York, and also to a modified extent the exchanges in Holland and the Scandinavian countries. The purchases include those made by the Bank of England before the appointment of the Committee, amounting to $233,000,000 or, in sterling, to £46,600,000, and also those securities which were bought after they had been loaned to the Treasury, the sterling equivalent of which amounted to £24,360,000.

	Purchases.	Loaned Securities.	Total.	No. of Different Securities.
Dollar Bonds .	$ 680,014,944	197,856,380	877,871,324	1,421
Dollar Shares .	$ 241,317,761	303,593,880	544,911,641	389
Sterling Bonds .	£ 27,803,232	115,160,124	142,963,356	123
Sterling Shares .	£ 875	—	875	1
Registered Stocks.	£ 4,119,358	171,851,047	175,970,405	40
Home Railways .	£	17,494,182	17,494,182	43
Franc Bonds .	Fcs.	8,458,500	8,458,500	2
Krone Bonds .	Kr.	8,152,100	8,152,100	3
Florin Bonds .	Fls. 111,600	4,374,600	4,486,200	4
Florin Shares .	Fls. 5,341,100	—	5,341,100	1
				2,027

For the purpose of arriving at the aggregate amounts of the securities acquired, the various currencies have been converted into sterling at the customary rates, viz., 5 dollars to the £, 25 francs to the £, 18 kroner to the £, and 12 florins to the £—

	Purchases.	Loaned Securities.	Total.
	£	£	£
Dollar Bonds . .	136,002,988	39,571,276	175,574,264
Dollar Shares . .	48,263,552	60,718,776	108,982,328
Sterling Bonds . .	27,803,232	115,160,124	142,963,356
Sterling Shares . .	875	—	875
Registered Stocks . .	4,119,358	171,851,047	175,970,405
Home Railways . .	—	17,494,182	17,494,182
Franc Bonds . . .	—	338,340	338,340
Krone Bonds . .	—	452,894	452,894
Florin Bonds . .	9,300	364,550	373,850
Florin Shares. . .	445,091	—	445,091
	216,644,396	405,951,189	622,595,585

The figures on previous page do not include a special creation of $40,000,000 Canadian Pacific Railway 4 per cent. Dollar Debenture Stock deposited by the Canadian Pacific Railway Company.

	£
From the foregoing statement it will be seen that the total securities purchased amounted to	216,644,000
of which the Bank of England bought	46,600,000
and the American Dollar Securities Committee . .	£170,044,000

The deposits on loan at 31st March, 1919, amounted to .	405,951,000
The deposits on loan sold to Treasury amounted to .	24,360,000
and the special deposit of the Canadian Pacific Railway Company amounted to	8,000,000
Making the total amount actually deposited . . .	£438,311,000

The Dollar Securities can be analysed to a limited extent, thus—

	Purchased.	Loaned.	Total.
	£	£	£
Dollar Bonds . .	136,002,988	39,571,276	175,574,264
Dollar Shares . .	48,263,552	60,718,776	108,982,328
	184,266,540	100,290,052	284,556,592
Deduct Canadian securities included . . .	6,651,836	27,361,344	34,013,180
American securities .	177,614,704	72,928,708	250,543,412

It will be seen that, of the American Dollar Securities, amounting to £250,543,000, which came into the possession of the Treasury, £177,614,000, or 71 per cent., were purchased for re-sale in New York, and £72,928,000, or 29 per cent., are still held by this country.

The foregoing statements furnish an indication of the work resulting from the operations of the Committee as the position stood at the 31st March, 1919.

Since that date the additional special Income Tax of 2s. in the £ was discontinued as from the 6th April, 1919, the purchase by the Treasury of deposited securities was discontinued on the 28th April, and, the required three months' notice having been given, the return of registered stocks to the amount of £67,615,000 commenced on 1st April.

The result of the endeavours to maintain the New York Exchange to which the operations of the Committee contributed was that a practically uniform rate of $4·76$\frac{7}{16}$ to the £ was maintained until the 21st March, 1919, when the control was removed.

Government Revenue, Borrowings, and Expenditure Since the Commencement of the War

In the following tables, Government Revenue, Borrowings, and Expenditure are shown separately for the eight-month period—2nd August, 1914–31st March, 1915; and for the fiscal years ending 31st March, 1916–1921. This division clearly discloses the rapid increase in war expenditure during the course of the war—

Year Ending 31st March, 1915

	£		£
Total Expenditure. .	560,473,533	Revenue	226,694,080
Increase in Exchequer Balances	73,016,433	Net Borrowings . .	406,795,886
	£633,489,966		£633,489,966

1st April–1st August, 1914 (Pre-War)

	£		£
Total Expenditure .	62,113,553	Revenue	54,935,336
Decrease in Exchequer Balances	5,374,131	Net Borrowings . .	1,804,086
	£56,739,422		£56,739,422

War Period
2nd August, 1914–31st March, 1915

	£		£
Total Expenditure .	498,359,980	Revenue	171,758,744
Increase in Exchequer Balances . . .	78,390,564	Net Borrowings . .	404,991,800
	£576,750,544		£576,750,544

Daily average of total expenditure, £2,059,000.

Daily average of total expenditure for year ending 31st March, 1914 (pre-war), £541,000.

YEAR ENDING 31ST MARCH, 1916

	£		£
Total Expenditure .	1,559,158,377	Revenue	336,766,824
Decrease in Exchequer Balances . . .	57,875,946	Net Borrowings . .	1,164,515,607
	£1,501,282,431		£1,501,282,431

Daily average of total expenditure, £4,260,000.

YEAR ENDING 31ST MARCH, 1917

	£		£
Total Expenditure .	2,198,112,710	Revenue	573,427,582
Increase in Exchequer Balances . . .	860,853	Net Borrowings . .	1,625,545,981
	£2,198,973,563		£2,198,973,563

Daily average of total expenditure, £6,022,000.

YEAR ENDING 31ST MARCH, 1918

	£		£
Total Expenditure .	2,696,221,405	Revenue	707,234,565
Decrease in Exchequer Balances . . .	5,405,829	Net Borrowings . .	1,983,581,011
	£2,690,815,576		£2,690,815,576

Daily average of total expenditure, £7,387,000.

YEAR ENDING 31ST MARCH, 1919

	£		£
Total Expenditure .	2,579,301,188	Revenue	889,020,825
Decrease in Exchequer Balances . . .	8,230,524	Net Borrowings . .	1,682,049,839
	£2,571,070,664		£2,571,070,664

Daily average of total expenditure, £7,067,000.

On 11th November, 1918, Armistice signed with Germany.

YEAR ENDING 31ST MARCH, 1920

	£		£
Total Expenditure .	1,665,772,928	Revenue	1,339,571,381
Decrease in Exchequer Balances . . .	3,430,409	Net Borrowings . .	322,771,138
	£1,662,342,519		£1,662,342,519

Daily average of total expenditure, £4,551,000.

On 28th June, 1919, Germany signed the Peace Terms.

YEAR ENDING 31ST MARCH, 1921

	£		£
Total Expenditure .	1,195,427,877	Revenue	1,425,984,666
Decrease in Exchequer Balances . . .	6,294,591	Net Repayments . .	236,851,380
	£1,189,133,286		£1,189,133,286

Daily average of total expenditure, £3,275,000.

SUMMARY FOR SIX YEARS AND FOUR MONTHS
2ND AUGUST, 1914–31ST MARCH, 1921

	£		£
Total Expenditure .	12,392,354,465	Revenue	5,443,764,587
Decrease in Exchequer Balances . . .	1,985,882	Net Borrowings . .	6,946,603,996
	£12,390,368,583		£12,390,368,583

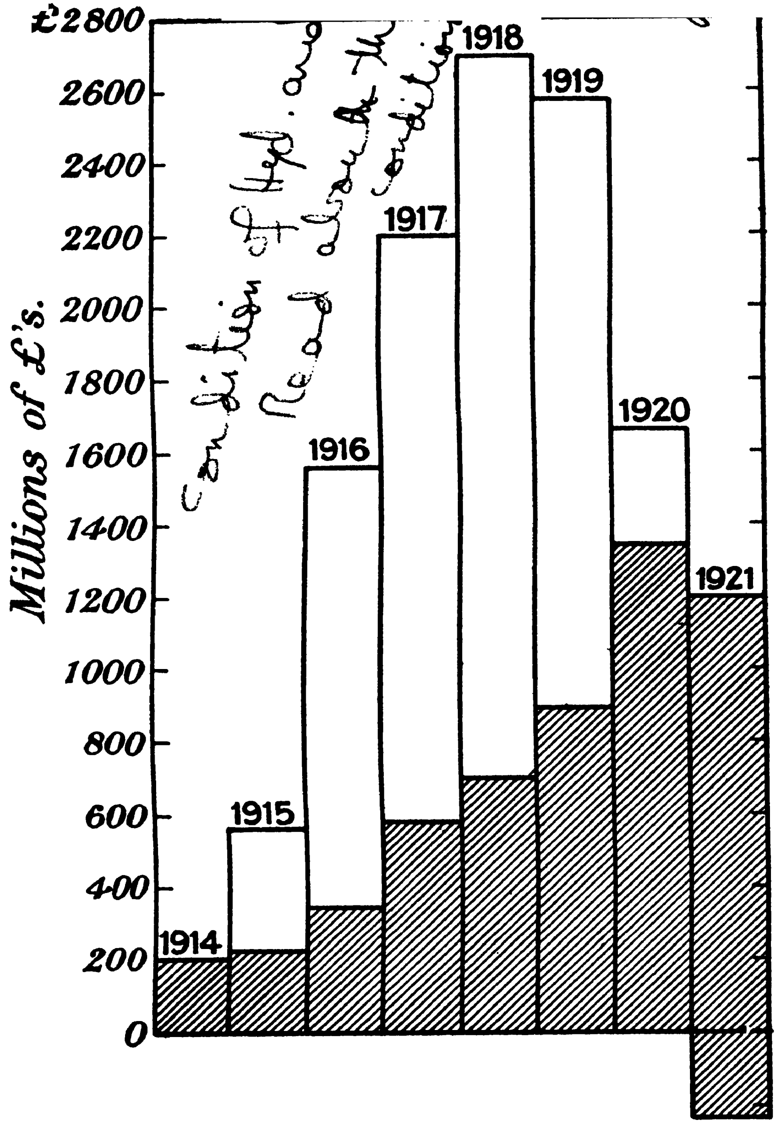
The expenditure amounts shown in the foregoing tables include loans to Allies and Dominions. The following table shows the amount of such loans and the periods during which they were made, according to statements made by the Chancellor of the Exchequer at different dates—

ADVANCES TO ALLIES AND DOMINIONS
(Million £'s)

	Advances 1st Aug., 1914, to 31st Mar., 1916.	Advances during Financial Year 1916-17.	Advances during Financial Year 1917-18.	Advances during Financial Year 1918-19.	Advances during Financial Year 1919-20.	Total Advances from 1st Aug. 1914, to 31st Mar. 1920.
Dominions .	88	59	47	−23	−51½	119½
Allies .	288	539	505	236	163	1731
Total .	376	598	552	213	111½	1850½

A graphical representation, in columnar form, of the total expenditure, revenue, and net borrowings (for 1921 net repayments) for each of the last eight fiscal years, is shown on the next page.

A table is given on page 201 showing the various forms of Government borrowing since the commencement of the war up to 31st March, 1921. The amounts given under the heading "Receipts" do not represent the actual amounts of the various forms of loans outstanding on 31st March, 1921, for conversions and part redemptions have materially altered many of the amounts since first received.



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TOTAL EXPENDITURE FOR FISCAL YEARS ENDING
31ST MARCH

Shaded parts represent Revenue. Unshaded parts represent net Borrowings. Shaded part below base line represents net repayments during fiscal year ending 31st March, 1921. Total expenditure is represented by height of columns from base line.

Government Borrowings, Revenue, and Expenditure

From 2nd August, 1914, to 31st March, 1921.

		Exchequer Receipts.
		£
3½ per Cent. War Loan, 1925–28[1]		331,798,408
4½ per Cent. War Loan, 1925–45[2]		592,479,544
4 per Cent. War Loan, 1929–42, and 5 per Cent. War Loan, 1929–47		948,459,330
4 per Cent. Funding Loan, 1960–1990		231,146,047
4 per Cent. Victory Bonds		244,695,776
3 per Cent. Exchequer Bonds, due 1920		47,942,345
3 per Cent. Exchequer Bonds, due 1930		12,824,800
5 per Cent. Exchequer Bonds due 1919, 1920, 1921, 1922		416,862,065
5½ per Cent. Exchequer Bonds, due 1925		67,215,784
6 per Cent. Exchequer Bonds, due 1920		161,000,565
National War Bonds, due 1922, 1923, 1924, 1925, 1927, 1928, 1929		1,732,793,516
Treasury Bonds (5–15 years)		22,584,233
Net increase in Treasury Bills outstanding		1,105,341,000
War Expenditure Certificates		23,561,000
War and National Savings Certificates		339,140,794
5 per Cent. U.S.A. Loan (issued October, 1915)		50,820,023
Other Debt created under the War Loan Acts, 1914–19 (which includes proceeds of Loans raised abroad)		1,309,542,281
Temporary Advances (Ways and Means)		153,489,000
Subtract following issues out of Exchequer—		7,791,696,511
Exchequer Bonds redeemed under the War Loan Redemption Act, 1910	16,395,500	
Issues under Section 1 (5) of the War Loan Act, 1915	170,143,313[3]	
War Loans, Exchequer Bonds, etc., under Finance Acts, 1916 (Section 61) and 1917 (Section 34)	232,812,985	
Exchequer Bonds paid off	134,657,609	
War Expenditure Certificates under War Loan Act, 1916	23,561,000	
Principal of National Savings Certificates	54,600,000	
American Loan, 1915, redeemed	59,229,221	
Depreciation Fund under Finance Act, 1917	122,361,026	
Issues under the Civil Contingencies Fund Act, 1919	29,489,814	
Excess of other Issues over other Receipts	1,842,047	
		845,092,515
Net borrowings, 2nd Aug., 1914–31st March, 1921		6,946,603,996
Add Revenue for same period		5,443,764,587
		12,390,368,583
Add decrease in Exchequer Balances		1,985,882
Total declared expenditure for period 2nd Aug., 1914–31st March, 1921, chargeable against revenue		**£12,392,354,465**

[1] Through Conversions £62,745,000 in issue on 31st March, 1920.
[2] £13,007,000 in issue on 31st March, 1920, owing to Conversions.
[3] Includes repayments to Bank of England of £160,427,623.

CHAPTER VII

GOVERNMENT REVENUE

THE following table shows the revenue, and the percentage it bore to the total expenditure for each fiscal year since 1914—

For Fiscal year ending 31st March.	Total Expenditure.	Total Revenue.	Revenue expressed as percentage of Expenditure.	Estimated Normal Revenue.[1]	Excess of Actual over estimated Normal Revenue.
	£ (millions.)	£ (millions.)	%	£ (millions.)	£ (millions.)
1914 . .	197	198	100·5	196	2
1915 . .	561	227	40·4	207	20
1916 . .	1,559	337	21·6	212	125
1917 . .	2,198	573	26·1	217	356
1918 . .	2,696	707	26·2	222	485
1919[2]. .	2,579	889	34·5	227	662
	9,593	2,733		1,085	1,648
1920 . .	1,666	1,340	80·4	232	1,108
	11,259	4·073		1,317	2,756
1921 . .	1,195	1,426	119·3	237	1,189
	12,454	5,499	—	1,554	3,945

[1] If the war had not taken place; but the annual increases would not have been equal.

[2] Armistice made with Germany, 11th November, 1918. Peace signed 28th June, 1919.

It will be observed from the above table that, since 1914, there was a considerable expansion in revenue each year, the greatest expansions taking place during the fiscal years ending 31st March, 1917, 1919, and 1920. (More than half the expansion in the last named year was due to sale of surplus war stores and other assets.) It will also be noted from the figures that there was a surplus of £231,000,000 for the fiscal year ending 31st March, 1921, as against a deficit of £326,000,000 for the previous fiscal year. As soon as it was recognized that the war was likely to prove of long

duration, the Government did not hesitate to impose a considerable increase in taxation with each[1] successive Budget,[2] not only with the object of financing as great a part as possible of war expenditure out of revenue, but also with the object of increased taxation compelling reduction in civilian consumption of goods and services at a time when war conditions demanded general public economy. A great war necessarily entails a considerable transference of national energy from peace time production to war requirements, the economic line of division being reached when any further transference of purchasing power from the public to the Government would involve impaired efficiency and reduced output of munitions and other goods and materials required for the prosecution of hostilities.

The total revenue received since 1914 includes, of course, the amount that would have been received under peace conditions. It is not possible to state definitely what such amount would have been if the war had not taken place, but in the foregoing table it will be observed that an allowance has been made for an average annual increase of £5,000,000 in normal revenue in estimating the total extra revenue raised during the six years 1st April, 1914–31st March, 1920, namely £2,756,000,000 ; or during the seven years 1st April, 1914–31st March, 1921, namely, £3,945,000,000. It is very evident that such an enormous amount of increased revenue could not have been raised except for the great increases in profits, wages, and salaries during the same period.

As to the sources from which the extra revenue was obtained, the first of the tables given at the end of the chapter shows that, in the main, the increase was derived from Income Tax, Excess Profits Duty (a new tax and reviewed later), Customs and Excise.

[1] No material new taxation was imposed by the Budget of 4th May, 1915, a further increase in Income Tax rates for the fiscal year 1915–1916 having been provided for in the Supplementary Budget of 17th November, 1914. Mr. J. E. Allen considers that the Government should have imposed much greater taxation during the war, particularly in its early stages.

[2] The dates on which the various Budgets between 1914 and 1921 were introduced into the House of Commons were as follows : 4th May, 1914 (Mr. Lloyd George) ; 17th November, 1914 (Supplementary, Mr. Lloyd George) ; 4th May, 1915 (Mr. Lloyd George) ; 21st September, 1915 (Supplementary, Mr. McKenna) ; 4th April, 1916 (Mr. McKenna) ; 2nd May, 1917 (Mr. Bonar Law) ; 22nd April, 1918 (Mr. Bonar Law) ; 30th April, 1919 (Mr. Austen Chamberlain) ; 19th April, 1920 (Mr. Austen Chamberlain) ; 25th April, 1921 (Mr. Austen Chamberlain, on behalf of Sir Robert Horne, the new Chancellor of the Exchequer).

A large amount (*see* miscellaneous special receipts) was also received from sale of surplus war stores after the termination of the war. The actual increases recorded under the headings Postal, Telegraph, and Telephone Services were relatively small, and were necessitated by the increased cost of maintaining such public services.

It is not possible in a space of a chapter to review in detail the various alterations made in individual taxes and duties since 1914, but it may be said that nearly all taxes or duties which were in operation before the war were considerably increased during its continuance. The Income Tax underwent several alterations, both in rates and allowances. Certain new taxes were also imposed, the main new revenue producing measure being the Excess Profits Duty, considered below.

Excess Profits Duty

Very early in the war there was a growing volume of opinion that some form of limitation should be placed on producers, manufacturers, traders, and others extracting abnormally large profits from the community duing the continuance of hostilities. Very large profits were being easily made on account of scarcity conditions, created by Government demand for war requirements competing severely with civilian demand. It was rightly contended that various members of the community should not be permitted unduly to enrich themselves out of war conditions whilst large numbers of men were fighting and dying for their country on the battle-fields.

Recognizing the equity of a tax on abnormal profits indirectly due to conditions created by the war, the Chancellor of the Exchequer (Mr. McKenna), in the Supplementary Budget introduced into the House of Commons on 21st September, 1915, announced a new tax to be known as the Excess Profits Duty. This tax provided that 50 per cent. of all profits above a defined "pre-war standard" were to be paid over to the Treasury, but the duty was not to apply to farmers and professional men. It was estimated by the Treasury that the tax would yield £30,000,000 on estimated excess profits of £60,000,000 *in a full effective war year.* This amount later proved to have been a very serious

under-estimate.[1] In successive Budgets the estimated yield was very greatly increased, and approximated to actual receipts. In the Budget introduced on 4th April, 1916, the Excess Profits Duty was increased to 60 per cent., and in that introduced on 2nd May, 1917, to 80 per cent. At the latter percentage it remained until reduced to 40 per cent. by the Budget introduced on 30th April, 1919. The duty was again raised to 60 per cent. in the Budget introduced on 19th April, 1920, and was finally removed in the Budget introduced on 25th April, 1921, a promise of such removal having been previously made by the Chancellor of the Exchequer (Mr. Austen Chamberlain) in a speech made at Birmingham on 3rd February, 1921.

The table given below shows the yield of the Excess Profits Duty for each year since its imposition. In connection with this table it has to be borne in mind that there was, for various reasons, considerable delay in the collection of the tax, often amounting to over twelve months, and that there was also some evasion of the full liability under the tax.

YIELD OF EXCESS PROFITS DUTY COLLECTED BY THE EXCHEQUER

For year ending 31st March	£
1916	140,000
1917	139,920,000
1918	220,214,000
1919	285,028,000
1920	290,045,000
1921	219,181,000
Total.	£1,154,528 000

The above figures include a relatively small amount received from controlled firms (Munitions Levy).

In introducing the Budget on 25th April, 1921, for the fiscal

[1] In an article that appeared in the *Bankers' Magazine* for December, 1915, Mr. A. H. Gibson pointed out that a very grave under-estimate had been made of the yield to be eventually derived from the Excess Profits Duty in a full effective war year. Mr. Gibson gave reasons and calculations for estimating the yield, on a 50 per cent. basis, at between £200,000,000 and £250,000,000, and also expressed his opinion that there was bound to be considerable delay and some leakage in collection. The basis of the calculation was the Budget estimate of borrowings for the current fiscal year, due allowances being made for the pre-war rate of national savings, borrowings abroad, sales of foreign investments, and other factors.

year ending 31st March, 1922, Mr. Austen Chamberlain stated that nearly £300,000,000 of Excess Profits Duty was in process of assessment, and a further large amount remained to be assessed. He pointed out, however, that a very large amount must be allowed for adjustments on appeal, and for repayments on account of deficiency in the case of businesses which were suffering from the trade depression. The estimated receipts from the duty for the current fiscal year were £120,000,000.

The Excess Profits Duty was a well-intentioned tax, but unfortunately it gave rise to very unexpected evils, under conditions of scarcity. Generally speaking, it was passed on to the consumer; it became an indirect tax on commodities. Whilst scarcity conditions remained, and until the slump in trade, it was the practice of manufacturers and traders, in fact, of all who were likely to be subject to the tax, to fix the selling price of goods they offered for sale at such an amount as would yield them a substantial net profit *after* payment of Excess Profits Duty. Experience soon proved that such net profit was usually considerably in excess of the pre-war customary amount. In connection with this matter, the Report (Cmd. 858, p. 4) of the Committee appointed to investigate the prices, costs, and profits of the manufacture of Yorkshire Tweed Cloths contained the following statement: "In practice, we find that Excess Profits Duty is added by manufacturers to the prime cost of the article and is an important factor in putting up prices."

The passing on to the consumer of Excess Profits Duty brought in its wake the following cumulative evils: (1) Further demands for increases in wages and salaries; (2) further inflation of credit and currency; and (3) materially increased cost of necessary war materials. Through accelerating and being one of the causes of the rise in prices, it brought particular hardship on people with fixed incomes. Finally, the tax led to extravagance by those to whom it was applicable, and at a time when there was urgent necessity for the greatest possible national economy. Whatever increased general charges or expenses were incurred by a firm or individual subject to the duty, the Government obviously paid indirectly a large part of such increase, the proportion varying with the tax percentage, and being in the first instance extracted from the consumer.

Taxation Policy During the War

From the particulars already given of the revenue since 1914 (and the tables at the end of the chapter), it is obvious that the Government financed a considerable part of the immediate cost of the war out of the proceeds of taxation. After the declaration of Peace, the surplus receipts from the Revenue were devoted to part liquidation of war-time borrowings abroad and of the floating debt as represented by Treasury Bills and Ways and Means Advances. But notwithstanding the enormous increase in taxation made during the war, there were many authorities who considered that taxation should have been made a still heavier burden on the community during hostilities, partly with the object of lessening additions to the National Debt, and partly with the object of enforcing greater economy in civilian consumption of goods and services. Doubtless further taxation to the extent of 10 to 20 per cent. could have been placed on the community, in particular during the early stages of the war, but the degree to which taxation may at any time be safely imposed must obviously be largely governed by certain general considerations. In matters appertaining to finance, the Government has at all times to bear in mind the current temperament of the public, and to consider any proposed change or additional burden on the community from the standpoint of expediency. During the war the increased taxation, direct and indirect, pressed very severely on people with fixed incomes, and any further material increase might have broken up a large number of homes. Under the scarcity conditions ruling during the war, producers, manufacturers, and traders were easily able to pass increased taxation on to the consumer.

An equitable imposition of taxation is at all times an exceedingly difficult matter, if not impossible. Money wages and profits can usually adjust themselves somewhat to increased taxation, whether direct or indirect, particularly if there be increased production, but not the purchasing power of people with fixed incomes. Such people pay not only their share of direct and indirect taxation, but also part of the direct taxation that should be borne by others, which is, however, passed on to the consumer in the prices of commodities. An equitable system of taxation would therefore demand special abatements in direct taxation borne

by people with fixed incomes, if such concessions were at all practicable.

The adoption of the principle "ability to pay" is admittedly the ideal equitable basis of taxation at all times, but it would seem impossible to maintain it unimpaired under war conditions, which inevitably cause large economic disturbances. Rapid and widespread changes took place in the distribution of the national income during the recent war, not only on account of economic disturbances, but also largely through inflation and apparent but artificial prosperity of some classes created by the free spending of Government funds on war requirements. The sacrifices essential during the recent war were, in consequence, very unequally distributed, in particular, the fixed income classes were compelled to make a proportionately greater contribution than the producing and other classes.

The new tax, known as the Excess Profits Duty, brought in its wake, as already stated, many unexpected cumulative evils. The principle of the tax was sound, but it ran up against human nature—the insatiable desire of some people to extract larger profits from the community whenever possible, and under peace or war conditions. A 100 per cent. tax on excess profits would probably have caused less inflation and less social discontent, but there would have been no inducement left, to those who require the spur of larger profits, for the exercise of greater energy and industry. For this reason, the Munitions Levy, which applied to controlled firms, and was a 100 per cent. tax on profits over a certain amount, practically failed as a revenue producing measure. Its enemy was human nature. The amount collected under this tax from all controlled firms was almost negligible. Possibly the least objectionable tax that could have been imposed during the war would have been a steeply graduated tax on *increases* of net income. It would have had less influence in raising prices than the Excess Profits Duty. Taxes which lead to extravagance, very high prices, or restriction of output, are obviously bad from a national standpoint.

If it had been possible to increase taxation by a further, say, £1,000,000,000 for the five-year period 1915–1919, spread equitably over all classes without causing grave social disorders, the National Debt would probably have been at least £2,000,000,000 less than

its present amount. As a result of such further increase in taxation, there would have been less civilian consumption of goods and services, less necessity for inflation, and, in consequence, the Government would have had to pay less for the goods and services it required for the prosecution of hostilities. Greater taxation would therefore have been accompanied by lesser prices and reduction in necessary loans. The consumer would have received some compensation for the higher taxation in a reduction or slackening in the rise in the cost of living. In particular, considerably increased taxation was desirable during the first two years of war in order to check or reduce the tendency of prices to rise owing to scarcity conditions. In this event there would have been less necessity for increases in wages, and less inflation. The worst penalty for making large additions to the National Debt during a period of rapidly rising prices is that the burden of repayment increases later when prices fall and tend to become normal again.

Whatever be the maximum amount the Government could have possibly raised in taxation during the recent war, it will be a matter of wonder to future historians that the country was able to increase its revenue from £198,000,000 for the year ending 31st March, 1914, to £1,340,000,000 for the year ending 31st March, 1920. That such an enormous increase was possible in a period of six years is due to the fact that the national income, measured in money, increased enormously during the war, through the lavish expenditure of borrowed money and the effects of inflation. The national income before the war was officially estimated at £2,200,000,000-£2,400,000,000. For the year 1919, the amount would probably not be far short of £5,000,000,000, the increase in the main being due to higher profits, wages, and salaries, the result of scarcity and inflation conditions. The whole of this increase can obviously not be maintained in immediate future years, and consequently a fall in the yield from existing taxes is to be expected during coming years, with the exception of receipts from Estate Duties, which are likely to rise as a result of the accumulation of war wealth by sundry persons.

Whilst referring to the national income, it is interesting to observe that the National Debt at the end and the national income at the commencement of the recent war, and at the

end and commencement of the Napoleonic Wars, bore similar ratios—

National Debt after Great European War.	. £7,876,000,000	(1920)
National Income before Great European War	. £2,300,000,000	(1913)
	Ratio 3·4 to 1	
National Debt after Napoleonic Wars .	. £846,000,000	(1816)
National Income before Napoleonic Wars	. £250,000,000[1]	(1792)
	Ratio 3·4 to 1	

[1] Estimate quoted by Mr. Joseph Kitchen. Page 237, Credit, Industry and the War, 1915.

Throughout the war there was conflict of opinion as to the relative proportion of necessary increased taxation to be added to direct or indirect taxation. At all times this is a matter that must be largely determined on grounds of expediency, equitable distribution, ease of collection, and other considerations. But there is much to be said in support of the opinion that all individuals should, as far as practicable, have brought home to them in the form of direct taxation the amount they pay for being members of the State, if increases in direct taxation can be equitably imposed, easily collected, and made without causing grave social discontent, otherwise increased indirect taxation may be preferable in the long run. In the case of intoxicating liquors, duties thereon are necessary to restrict consumption for health and social reasons.

Taxable Capacity of Country

On every occasion before and during the war, whenever a Budget imposed a considerable amount of new taxation, many people have expressed the opinion that the taxable capacity of the community had been exceeded, and that dire results would follow the imposition of the additional taxation. And yet subsequent experience proved the falsity of such previously held opinions. The interesting question therefore arises—on what basis does ultimately rest the real taxable capacity of a country? The answer is that the amount is closely connected with the level of prices, productive capacity, the current standard of living, and equitable distribution of taxation. It is obviously therefore a variable amount, for production is largely dependent on hours of labour, willingness of all workers, mental and physical, to put forth their best efforts whilst at work, application of machinery and other aids to industry, and invention. To get at the truth of many financial problems it

is often advisable to consider them from the economic standpoint, to think in terms of goods and services, and not in money and its equivalents, which are only the media of exchange. The real meaning of taxation is that the community makes a free gift annually of a certain amount of goods and services to those whom the community chooses to govern, to protect the national interests and territory, to provide certain public utility services, and to those who are prevented from supporting themselves on account of physical disabilities or age reasons. The administrators or distributors of such goods and services are the Government and local governing councils. In reality, a soldier whilst protecting his country, actively or potentially, is given goods and services by other members of the community in exchange for such protection. On discharge from the Army, should he then be entitled to a pension, goods and services, though of lesser amount, are still given to him as deferred part-payment of past services. Similarly in the case of all paid public officials. Interest received on account of holdings of Government securities is equivalent to an annual payment by the Government of goods and services for past goods delivered or other services rendered to the State.

Taxation can therefore usually be increased safely with every increase in production (per head of population) without affecting the current standard of living. Should an increase in taxation be greater than increase in current production, it will tend to act as a spur to greater efforts by those who desire to maintain their customary standard of living. Generally speaking, however, increases in taxation in normal times should not absorb the whole of increased production, in order that there may be a margin left for a general raising of the standard of living, and as an inducement to still greater production. When taxation increases at a greater rate than production, comforts and luxuries have necessarily to be reduced, and eventually a stage would be reached when lesser efficiency of producers, or social disturbances, would cause a reduction in output, and indirectly lesser exchequer receipts. The taxable capacity of a country is therefore closely connected with current production and an equitable distribution of taxation based on the principle "ability to pay." It cannot be definitely fixed at a certain percentage amount of the national income as expressed in money. When taxation exceeds the economic taxable capacity of

a community, it will usually disclose itself by growing social discontent. Before the war, taxation might have been increased by a further 50 per cent., if equitably distributed, without materially affecting the economic conditions of the country.

Estimated Government Revenue and Expenditure

For Fiscal Year Ending 31st March, 1922

Ordinary Receipts and Expenditure

	£
Customs	126,800,000
Excise	196,200,000
	323,000,000
Motor Tax	9,000,000
Estate Duties	48,000,000
Stamps	21,000,000
Land Tax and House Duty	2,500,000
Income Tax (including Super Tax and Mineral Rights Duty)	410,500,000
Excess Profits Duty	120 000,000
Corporation Profits Tax	30,000,000
	632,000,000
Post Office	60,000,000
Crown Lands	650,000
Receipts from Sundry Loans	12,000,000
Miscellaneous Receipts	21,500,000
Total	1,058,150,000

Consolidated Fund Services.	£
National Debt Services—	
Inside the fixed Debt Charge	24,500,000
Outside the fixed Debt Charge	320,500,000
	345,000,000
Road Fund	8,400,000
Local Taxation Accounts, Etc.	11,115,000
Land Settlement	5,000,000
Other Consolidated Fund Services	1,757,000
Total Consolidated Fund Services	371,272,000
Supply Services.	
Army	95,963,000
Navy	80,479,000
Air Force	16,940,000
Civil Services	327,503,000
Customs, Excise, and Inland Revenue	14,701,000
Post Office Services	67,165,000
Total Supply Services	602,751,000
Total	974,023,000
Surplus	[1]84,127,000
Total	1,058,150,000

Special Receipts and Expenditure

	£
Special Revenue— Arising from the realization of War Assets	158,500,000
	158,500,000

	£
Liquidation of War Commitments	65,705,000
Surplus	[2]92,795,000
Total	158,500,000

[1] Against this surplus must be set contingencies, in particular in connection with the Coal Stoppage, which will adversely affect estimates both of revenue and expenditure to an extent which is not at present calculable.

[2] Against this surplus must be set liabilities at present unascertained arising out of the liquidation of War Agreements for the control of Railways, in particular, arrears of maintenance and deterioration.

Whether annual taxation to the extent of £800,000,000–£1,000,000,000 can safely be maintained during the next ten years or so, only experience, based on close observance of economic conditions, can prove. That part which is devoted to payment of interest on War Loans is, in the main, received back again by

the community. Interest will be a diminishing amount as reductions are effected in the National Debt and conversions to lower rates are successfully effected in the future. The charge on the Exchequer for pensions will also gradually diminish in future years. The degree of taxation, in so far as it affects costs of production, will have to be largely governed by the strength of future foreign competition. This in its turn will be dependent on output per hour, per unit of labour, within this country.

The Budget introduced into the House of Commons on 25th April, 1921, provided for an estimated total revenue for the fiscal year ending 31st March, 1922, of £1,216,650,000. This amount includes £964,000,000 receipts from taxes and £252,650,000 from non-tax revenue (inclusive of £158,500,000 arising from the realization of war assets). On the previous page there is given a statement showing particulars of estimated revenue and expenditure for the year ending 31st March, 1922. The Corporation Profits Tax shown in this Statement is a new small tax, introduced by the Budget of 19th April, 1920, on the profits of limited liability companies engaged in trade or similar transactions.

Returns of Revenue and Expenditure

On the next two pages are given tables showing the various sources of Government revenue and broad divisions of expenditure for each fiscal year since the commencement of the recent war, the figures for the year ending 31st March, 1914, being given for the purpose of comparison. The amounts given under the heading "Supply Services" in the expenditure table include the cost of the ordinary Civil Services, the Post Office Services, the Customs, Excise and Inland Revenue Departments, all expenses in connection with the Army, Navy, and Munitions (together with the sums expended thereon in peace time), loans and advances to Allies and Dominions, payments to the railways under the terms of control, purchases of foodstuffs by the Government, and sundry other charges arising out of the war, but exclusive of interest payments on the War Debt, which are chargeable under "Consolidated Fund Services." In the third table, revenue and net borrowings are shown expressed as percentages of the total expenditure.

SOURCES OF REVENUE

For Fiscal Year Ending 31st March (000's Omitted)

	1914.	1915.	1916.	1917.	1918.	1919.	1920.	1921.
	£	£	£	£	£	£	£	£
Customs	35,450	38,662	59,606	70,561	71,261	102,780	149,360	134,003
Excise	39,590	42,313	61,210	56,380	38,772	59,440	133,663	199,782
Motor Vehicle Duties	—	—	—	—	—	—	—	7,073
Estate, Etc., Duties	27,359	28,382	31,035	31,232	31,674	30,262	40,904	47,729
Stamps	9,966	7,577	6,764	7,878	8,300	12,438	22,586	26,591
Land Tax . . .	700	630	660	640	665	630	680	650
House Duty. . .	2,000	1,930	1,990	1,940	1,960	1,850	1,960	1,900
Property and Income Tax (including Super Tax).	47,249	69,399	128,320	205,033	239,509	291,186	359,099	394,146
Excess ProfitsDuty &c	—	—	140	139,920	220,214	285,028	290,045	219,181
Corp'ation ProfitsTax	—	—	—	—	—	—	—	650
Land Value Duties .	715	412	363	521	685	664	663	20
Receipts from Taxes	163,029	189,305	290,088	514,105	613,040	784,278	998,960	1,031,725
% of Total Revenue	(82·2)	(83·5)	(86·1)	(89·6)	(86·7)	(88·2)	(74·6)	(72·4)
Postal Service . .	21,190	20,400	24,100	24,350	25,200	29,400	31,000	36,100
Telegraph Service .	3,080	3,000	3,350	3,350	3,500	3,800	4,850	5,200
Telephone Service .	6,530	6,250	6,450	6,400	6,600	6,800	8,300	8,200
Crown Lands . .	530	545	550	650	690	760	680	660
Receipts from Sundry Loans, etc.—								
Ordinary Receipts / Special Receipts	1,580	1,277	2,432	8,056	6,056	11,679	1,004 / 13,948	991 / 29,779
Miscellaneous—								
Ordinary Receipts / Special Receipts	2,304	5,917	9,797	16,517	52,148	52,303	16,050 / 264,779[1]	25,389 / 287,940[1]
Receipts from Non-tax. Revenue . .	35,214	37,389	46,679	59,323	94,194	104,742	340,611	394,259
% of Total Revenue	(17·8)	(16·5)	(13·9)	(10·4)	(13·3)	(11·8)	(25·4)	(27·6)
Total Revenue . .	198,243	226,694	336,767	573,428	707,234	889,020	1,339,571	1,425,984

EXPENDITURE CHARGEABLE AGAINST REVENUE

For Fiscal Year Ending 31st March (000's Omitted)

	1914.	1915.	1916.	1917.	1918.	1919.	1920.	1921.
Consolidated Fund Services—	£	£	£	£	£	£	£	£
Permanent Charge on Debt . .	24,500	20,497	20,338	19,783	19,828	23,638	23,773	24,500
Interest, etc., on War Debt .	—	2,172	39,911	107,467	170,023	246,327	308,261	325,099
Road Improvement Fund .	1,395	1,528	694	—	—	—	—	8,937
Payments to Local Taxation Acs.etc.	9,734	9,529	9,757	9,896	9,731	9,681	10,746	10,785
Land Settlement	—	—	—	—	—	—	3,477	6,930
Other Consolidatd Fund Services .	1,694	1,694	2,788	1,974	1,670	1,699	1,948	1,796
Total Consolidated Fund Services	37,323	35,420	73,488	139,120	201,252	281,345	348,205	378,047
Supply Services	160,170[2]	525,054[2]	1,485,670[3]	2,058,993	2,494,969	2,297,956	1,317,568	817,381
Total Expenditure	197,493	560,474	1,559,158	2,198,113	2,696,221	2,579,301	1,665,773	1,195,428

[1] Includes sales of surplus war stores, materials, foodstuffs, etc.

[2] The normal expenditure upon Army and Navy for 1914–1915 was £77,179,000 and estimated for 1915–1916 at £80,336,000.

[3] Includes £160,428,000 repaid to the Bank of England during the year ending 31st March, 1916, for advances previously made for war purposes by that institution.

REVENUE, BORROWINGS, AND EXPENDITURE
For Fiscal Year Ending 31st March (000's Omitted)

	1914.	1915.	1916.	1917.	1918.	1919.	1920.	1921.
	£	£	£	£	£	£	£	£
Revenue . . .	198,243	226,694	336,767	573,428	707,234	889,020	1,339,571	1,425,984
Net Borrowings .	3,355	406,796	1,164,515	1,625,546	1,983,581	1,682,050	322,771	236,851[2]
	201,598	633,490	1,501,282	2,198,974	2,690,815	2,571,070	1,662,342	1,189,133
Change in Exchequer balances[1]	+ 4,105	+73,016	– 57,876	+ 861	– 5,406	– 8,231	– 3,431	– 6,295
Total Expenditure	197,493	560,474	1,559,158	2,198,113	2,696,221	2,579,301	1,665,773	1,195,428
	Percentage of Total Expenditure.							
Revenue . . .	100·38	40·45	21·60	26·09	26·23	34·47	80·42	119·29
Net Borrowings .	1·70	72·58	74·69	73·95	73·57	65·21	19·38	19·81[2]
	102·08	113·03	96·29	100·04	99·80	99·68	99·80	99·48
Change in Exchequer Balances[1].	+2·08	+13·03	– 3·71	+ 0·04	– 0·20	– 0·32	– 0·20	– 0·52
Total Expenditure	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00

[1] Subtract Increase +, add Decrease –.
[2] Net Repayments.

CHAPTER VIII

COST OF THE WAR

THE revised Budget estimate given by the Chancellor of the Exchequer before the war of the expenditure for the fiscal year ending 31st March, 1915, was £207,000,000. Assuming that the war had not taken place, and that the expenditure since 1914 had increased at the rate of £5,000,000 per annum, normal expenditure for the seven years ending 31st March, 1921, would have been about £207,000,000, £212,000,000, £217,000,000, £222,000,000, £227,000,000, £232,000,000, £237,000,000: total for seven years, £1,554,000,000. Subtracting this £1,554,000,000 from the actual expenditure, £12,454,000,000, under war conditions, there is obtained £10,900,000,000 as the cost of the war to the United Kingdom up to 31st March, 1921, inclusive of loans to Allies and Dominions. Assuming that £900,000,000 is eventually repaid by the Allies and Dominions (about half of the total loans thereto, an assumption made by the Chancellor of the Exchequer on 20th May, 1919), the money cost of the war to the United Kingdom up to 31st March, 1921, would be about £10,000,000,000. From this amount a further reduction of from £150,000,000 to £200,000,000 has to be made, representing estimated value on 31st March, 1921, of surplus war stores, raw materials, etc., remaining unsold at that date, and other war assets. Taking the higher figure, the money cost of the war up to 31st March, 1921, would be represented by £9,800,000,000. But this amount is only part of the money cost of the war. To obtain the total cost of the war there should also be added the capital value of the increased annual expenditure in the future as a consequence of the war (less interest on debt), the capital value (if such could be estimated) of the loss of lives and invalidism arising out of the war, and a deduction made for value of conceded territories and receipts from indemnities payable by enemy Powers. A relatively small addition should be made for other war liabilities not yet liquidated, such as payments under the agreements made with the railway companies. Probably the final net money cost of the war to the Government will be between £12,000,000,000 and £14,000,000,000.

A White Paper (Cmd. 779) issued by the Treasury on 29th June, 1920, and showing the estimated Exchequer expenditure in a " Normal " year for the future forms a basis for roughly estimating the capital value of increased annual expenditure arising out of the war. On the assumption already made, that the annual expenditure would probably have increased at an average rate of £5,000,000 per annum, if the war had not taken place, the expenditure for the fiscal year ending 31st March, 1922, would have amounted to about £242,000,000. The White Paper referred to estimates the future expenditure in a normal year to be £880,900,000, which amount includes £120,000,000 for war pensions and allowances to disabled members of the fighting forces and their dependants, and £320,000,000 for interest payable on the National Debt. Subtracting from the total £880,900,000, the ½ per cent. Sinking Fund provision, £32,500,000, and estimated normal expenditure of £242,000,000 (see above), there is obtained £606,000,000 as the immediate increased annual expenditure arising out of the war. The capitalization of this amount at 5 per cent. would be, roughly, £12,000,000,000, but this sum does not include extra revenue raised since 1914. It is impossible to estimate with any degree of accuracy the capital value of the other items (already referred to) that should be included in a calculation of the total cost of the war. The amount to be provided for pensions will, of course, be a gradually diminishing charge in future years, and also the amount for interest on the National Debt, particularly after conversions to lower rates in the future.

There is a very great distinction between the nominal money cost of the war and the real cost to the nation considered as a whole. The internal debt simply represents a redistribution of wealth within the community, and the creation of a mortgage by credit operations on posterity. The major part of the necessary increased annual Exchequer revenue will be disbursed within the United Kingdom. Mr. Edgar Crammond, in a Paper read before the Institute of Bankers on 7th June, 1920, estimated the real cost of the war to the United Kingdom as follows—

The principal losses of the United Kingdom through the war were: The capitalized value of war pensions, £1,300,000,000; moneys borrowed abroad by the British Government, £1,300,000,000; sales of British holdings in foreign investments, £1,000,000,000; losses of shipping with cargoes, and losses through suspension of renewal of railways, ports, machinery, works,

houses, buildings, and exhaustion of reserves of manufactured goods and raw materials, £1,600,000,000; total, £5,200,000,000.

Against this might be set: (1) New works and re-equipment of many old works with up-to-date plant; (2) loans to the Allies and Dominions; and (3) assets already received from Germany, and the value of the territories taken over under the Peace Treaty. These assets, together, accounted for about £2,000,000,000, leaving the net loss of wealth owing to the war at £3,200,000,000, or, say, £3,500,000,000, taking a broad estimate.

Official figures published on 1st January, 1920, gave the British Army casualties in the war as 662,083 killed, 140,312 missing and prisoners, and 1,644,786 wounded. The total number of troops supplied by the British Isles was 5,704,416.

It is impossible to estimate the capital value of the productive capacity of the lives lost during the war and of the reduction in productive capacity of those who have returned from the battlefields incapacitated or with impaired constitutions. In the early stages of the war it seemed likely that the increased vital force, owing to the open-air life and exercise, of those that would return from the war, might compensate from a national productive standpoint for a great part of the immediate losses in life and invalidism due to the war. The restriction on emigration during the war has afforded some economic advantage to the country.

From the productive standpoint, the worst feature of the war has been that it has left a legacy of unrest, has led to a movement for a too drastic reduction in the hours of labour, and that since its termination there has been an increasing tendency in the ranks of labour not to exert the maximum effort whilst at work. These are all very grave matters when the future of the country has to be considered, particularly when the United Kingdom has in future years to meet severe competition in foreign markets.

Whether the redistribution of internal wealth brought about by the war will eventually prove of economic benefit to the country as a whole must be a matter for individual opinion. One usual result of war is that the rich, as a class, become richer relatively to the poor. Many people have made their fortunes out of war requirements and the increase in prices due to the war and inflation. On the whole, the ordinary investor has not gained by the war; in fact, in a great number of cases he has lost both in capital and in reduction of net income due to increased taxation. Many comparatively wealthy people before the war may now be considered relatively poor persons.

The following particulars relating to sales of surplus war stores and of raw materials held on trading accounts were shown in a White Paper (Cmd. 1412) issued in July, 1921—

	£
Sales of surplus stores—	
From Armistice to 31st March, 1920	208,922,663
" 1st April, 1920, to 31st March, 1921	87,626,791
" 1st April to 30th June, 1921	7,204,432
Total	303,753,886
Sales of raw material on Trading Account—	
From Armistice to 31st March, 1920	226,712,640
" 1st April, 1920, to 31st March, 1921	51,747,663
(Sales of wool are included only to 31st December, 1920, stocks having been handed over to the British Australian Wool Realization Association as on 1st January, 1921.)	
From 1st April to 30th June, 1921	110,567
Total	278,570,870
Grand Total	582,324,756

The sales, including sales on forward contracts, of surplus stores represented approximately 88 per cent. of the total quantities notified as available for disposal to 30th June, 1921.

National Debt and Assets

Before the war, on 1st April, 1914, the total dead weight debt amounted to £651,000,000. Six years later, on 31st March, 1920, according to a White Paper (Cmd. 780), the dead weight debt amounted to £7,835,000,000.[1] Particulars of the National Debt and of the national assets at this latter date are shown on pages 222–224. The enormous increase in the National Debt as a consequence of the war is certainly a very grave matter, but the nation is not bankrupt, as certain members of both Houses of Parliament have occasionally proclaimed. National bankruptcy is impossible, as far as internal finance is concerned. The real meaning of the major part of the increase in the National Debt is that certain members of the community, in return for goods or services directly or indirectly supplied to the Government for the prosecution of the war, have obtained a lien on the future productive

[1] Subsequently adjusted to £7,829,000,000.

power and services of their fellow-countrymen. A bad economic feature of the increase in the National Debt is the very high rate of interest payable on the major part of it for a fairly long period of years. *The real measure of national indebtedness at any given time is the total amount of interest payable, per annum, by a country to holders of its obligations, rather than the issued capital amount of the obligations.*

The White Paper referred to did not give particulars of the external debt, stated to amount to £1,278,714,000, but it is well known that, in the main, the amount represents borrowings from the United States of America.[1] It was stated in the House of Lords on 18th February, 1920, that the debt due to the American Government on 14th February, 1920, was approximately £865,600,000, and a further sum of approximately £120,000,000 was due to other creditors in the United States. The debt due to other foreign countries (including the Argentine, Uruguay, Japan, and various neutrals) was approximately £150,000,000. These figures did not include debt due to the Dominions and Canada, and in particular to Canada.

The following table shows the respective amounts of the internal debt and external debt at 31st March, 1919, 1920, and 1921, from which it will be observed that the latter debt has been reduced £203,000,000 in the course of two years—

	Mar. 31, 1919.	Mar. 31, 1920.	Mar. 31, 1921.
	£	£	£
Internal Debt . .	6,070,000,000	6,550,000,000	6,411,000,000
External Debt[2] . .	1,365,000,000	1,279,000,000	1,162,000,000
Total Dead-weight Debt	7,435,000,000	7,829,000,000	7,573,000,000

Before the war, on 31st March, 1914, the dead-weight debt amounted to, in round figures, £651,000,000. Six years later, on 31st March, 1920, the above figures show it amounted to £7,829,000,000, an increase of £7,178,000,000. This increase is less than the increase in the French, but much greater than the

[1] Full detailed particulars of the External Debt at 31st March, 1919, 1920, and 1921, were shown in White Paper, Cmd. 142.

[2] Sterling equivalent at par of exchange.

increase in the Italian National Debt occasioned by the war, as the following figures show—

PUBLIC DEBT OF FRANCE AT 1ST JULY, 1920

	Francs.
Internal Debt, Perpetual and Redeemable . . .	121,949,000,000
Floating Debt	[1]51,464,000,000
Advances by banks	26,020,000,000
Foreign Debt	34,296,000,000
Total	233,729,000,000
Subtract Pre-war Public Debt	30,000,000,000
Increase due to War	[2]203,729,000,000

DEBT OF ITALIAN TREASURY AT 31ST OCTOBER, 1920

	Lire.
Pre-war Public Debt	13,439,000,000
War Loans	39,450,000,000
Treasury Bills (up to one year)	10,740,000,000
Three and Five Year Bonds.	4,570,000,000
Bank and State Notes issued for State Account . .	12,707,000,000
Foreign Loans	[3]20,594,000,000
Current Account with the Deposit and Loans State Bank	572,000,000
Total Public Debts	102,072,000,000
Subtract Pre-war Public Debt	13,439,000,000
Increase due to War	[4]88,633,000,000

With reference to the matter of interest payable on the loans made by the British Government to the Allies, the following statement was made in the House of Commons on 8th March, 1920, by the Chancellor of the Exchequer—

In the case of the Belgian War Debt no interest is charged, and it has been agreed that the Allied and Associated Governments shall accept German gold bonds in discharge of the principal of the debt. Further, no interest has been charged down to the Armistice on loans to Serbia and Montenegro. In the case of the other Allies, interest is not actually paid except in the case of one special transaction, but the amount, in some cases at 5 per cent., and in others at Bank Rate, is added periodically to the principal outstanding.

What proportion of the loans made by the British Government to her Allies will eventually be repaid it is impossible to estimate at the present time. As already stated, the Chancellor of the Exchequer on 20th May, 1919, gave an estimate that one-half of such loans would eventually be liquidated.

[1] Converted into francs at the par of exchanges.
[2] At par of exchange, Fcs. 25.22 to £1, equivalent to £8,078,000,000.
[3] Converted into lire at the par of exchanges.
[4] At par of exchange, Lir. 25.22 to £1, equivalent to £3,356,000,000.

National Debt

Estimated National Debt as on 31st March, 1920. The figures are partly estimated and are subject to modification for conversions not yet completed.

1. Dead Weight Debt.	
Internal Debt—	£
Funded Debt (Consols and other Pre-war Debt)	314,952,000
Terminable Annuities	19,314,000
3½% War Loan, 1925–8	62,745,000
4½% ,, ,, 1925–45	13,007,000
5 % ,, ,, 1929–47	1,977,109,000
4 % ,, ,, 1929–42	64,143,000
4 % Funding Loan, 1960–90	409,100,000
4 % Victory Bonds	359,500,000
5 % National War Bonds, 1922 (1st Oct.)	203,550,000
5 % ,, ,, ,, 1924 (1st Oct.)	26,350,000
5 % ,, ,, ,, 1927 (1st Oct.)	212,900,000
4 % ,, ,, ,, 1927 (1st Oct.)	101,700,000
5 % ,, ,, ,, 1923 (1st April)	212,700,000
5 % ,, ,, ,, 1925 (1st April)	11,900,000
5 % ,, ,, ,, 1928 (1st April)	149,300,000
4 % ,, ,, ,, 1928 (1st April)	48,000,000
5 % ,, ,, ,, 1923 (1st Sept.)	153,800,000
5 % ,, ,, ,, 1925 (1st Sept.)	18,300,000
5 % ,, ,, ,, 1928 (1st Sept.)	237,700,000
4 % ,, ,, ,, 1928 (1st Sept.)	26,200,000
5 % ,, ,, ,, 1924 (1st Feb.)	26,950,000
5 % ,, ,, ,, 1929 (1st Feb.)	42,500,000
5 % ,, ,, ,, 1929 (1st Feb.)	5,450,000
Exchequer Bonds, 1920, 1921, 1922, 1925, 1930	319,107,000
War Savings Certificates	275,081,000
Straits Settlements Loan (repayable in sterling)	1,375,000
Treasury Bills [1]	1,058,696,000
Ways and Means Advances	204,887,000
	[3]6,556,316,000
External Debt (at par) [2]	1,278,714,000
Total Dead Weight Debt	[4]7,835,030,000
2. Other Capital Liabilities—	£
Capital raised under special Acts for the interest on and repayment of which provision is made by annuities charged on Votes or otherwise outside the general debt service	46,863,000
Total Debt	£7,881,893,000

[1] Excluding Bills held as collateral for loans payable abroad, and included in External Debt.

[2] £82,600,000 debt due to Canada was cancelled in 1919–20, as shown in Command Papers 583, 616, and 651.

[3] This total has since been adjusted to £6,550,286,000.

[4] This total has since been adjusted to £7,829,000,000.

ASSETS

1.—WAR ASSETS.

(*a*) Obligations of the Allies and Dominions as on 31st March, 1920 :		
Obligations of Allies—	£	£
Russia	568,000,000	
France	514,800,000	
Italy	455,500,000	
Belgium (*a*) War	92,000,000	
,, (*b*) Reconstruction	5,300,000	
Serbia	20,900,000	
Portugal, Roumania, Greece, & other Allies	66,600,000	
Relief Loans	8,000,000	
		1,731,100,000
Obligations of Dominions—		
Australia	51,600,000	
New Zealand	29,600,000	
Canada	19,400,000	
South Africa	15,800,000	
Other Dominions and Colonies	3,100,000	
		119,500,000
Outstanding obligation of India in respect of 5% War Loan		21,000,000
		1,871,600,000
(*b*) Vote of Credit and other War Assets as estimated on 31st March, 1920—		
Ministry of Munitions :		
Surplus Stores (Disposal Board) and Raw Materials	£ 355,000,000	
Repayments due from Allied & Associated Governments	39,000,000	
Ministry of Shipping—		
Sale of Ships and Shipyards and Repayments due from Allied & Associated Governments	37,000,000	
Board of Trade—		
Stocks of Timber, Meat, Flax	22,500,000	
Ministry of Food, Wheat and Sugar Commissions	60,000,000	
War Office—		
Cost of Armies of Occupation	45,500,000	
Repayments due from Dominions	37,500,000	
Admiralty : Repayments due from Dominions and Associated Governments	1,500,000	
Treasury : Pre-moratorium Bill Advances, dollar adjustments & other cash balances	82,000,000	
Coal Deficiency Advances	20,000,000	
		700,000,000
Note.—It is estimated that of the total of £700,000,000, £300,000,000 will be received as Miscellaneous Revenue in 1920–21. In respect of the balance of £400,000,000 allowance must be made for contingencies such as realization on falling markets. £300,000,000 should, however, prove to be a conservative estimate of the ultimate receipt.		
(*c*) Arrears of Excess Profits Duty as on 31st March, 1920		310,000,000
Total War Assets		2,881,600,000

Receipts in respect of reparation from late enemy Powers are not included in these figures, and cannot be estimated until the Reparation Commission has dealt with the claims before it.

2. Other Assets—	£
Exchequer Balance on 31st March, 1920	9,369,000
Balance on Civil Contingencies Fund repayable to the Exchequer	36,500,000
Balance on the Depreciation Fund	7,192,000
Suez Canal Co.'s Shares, estimated market value	23,192,000
Anglo-Persian Oil Co.'s Shares and Debenture Stock, at cost	4,250,000
British Dyestuffs Corporation Shares, at cost	1,700,000
Cunard Steamship Co.'s Debenture Stock, nominal value	1,040,000
Loan to East Africa Protectorate	123,000
Exchequer Loans for Land Settlement	3,477,000
Funding Loan and Victory Bonds accepted for Death Duties	2,500,000
Miscellaneous (including Bullion advances outstanding)	6,000,000
Total	95,343,000

The obligations of the Dominions and Allies to the British Government on 31st March, 1921, were, according to a Budget White Paper, as shown below—

	£	£
Obligations of Dominions—		
Australia	90,000,000	
New Zealand	29,600,000	
Canada	13,800,000	
South Africa	7,500,000	
Other Dominions and Colonies	3,100,000	
		144,000,000
Obligations of Allies—		
Russia	561,400,000	
France	557,000,000	
Italy	476,800,000	
Belgium (a) War	94,400,000	
(b) Reconstruction	9,000,000	
Serbia	22,100,000	
Portugal, Roumania, Greece, and other Allies	66,200,000	
Relief Loans	16,700,000	
		1,803,600,000
Total		1,947,600,000

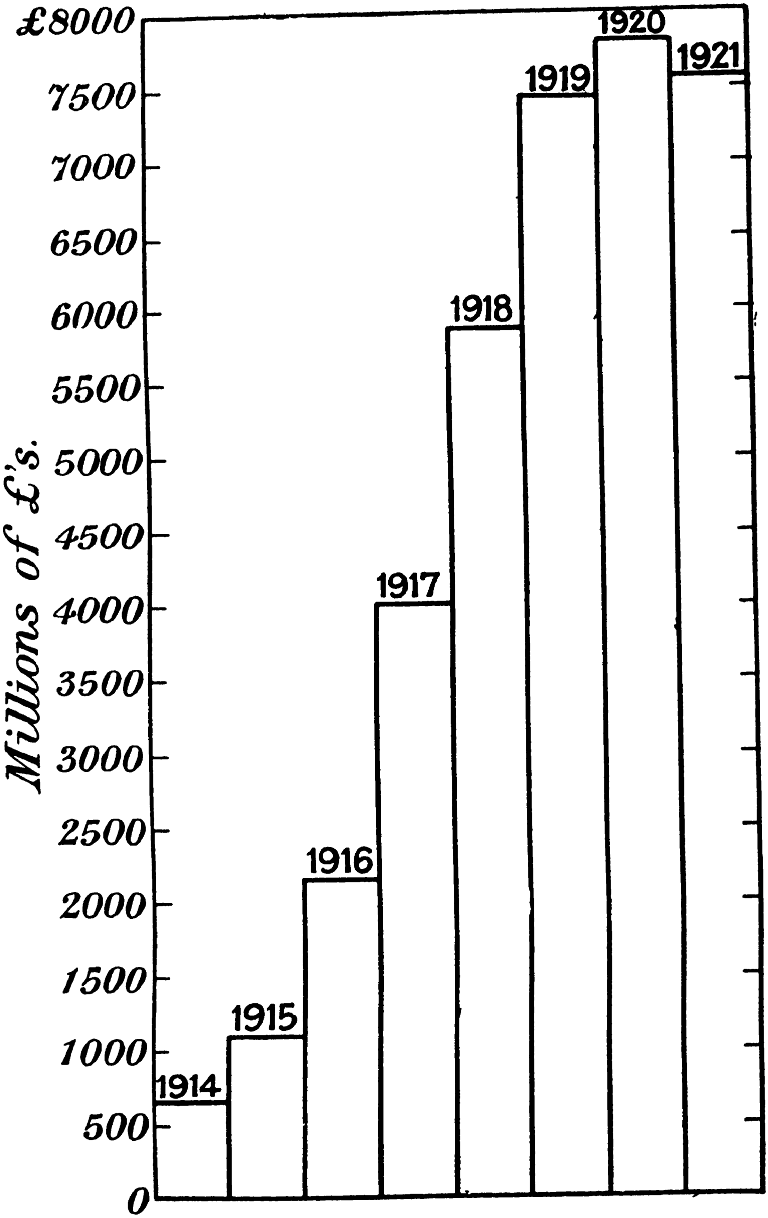
On pages 226 and 227 are shown two graphical representations, in columnar form, of the dead-weight debt in various years. The first represents the debt at 31st March, for each of the years

1914–1921 ; the second the debt before and after various wars. The actual amounts the columns represent are shown below—

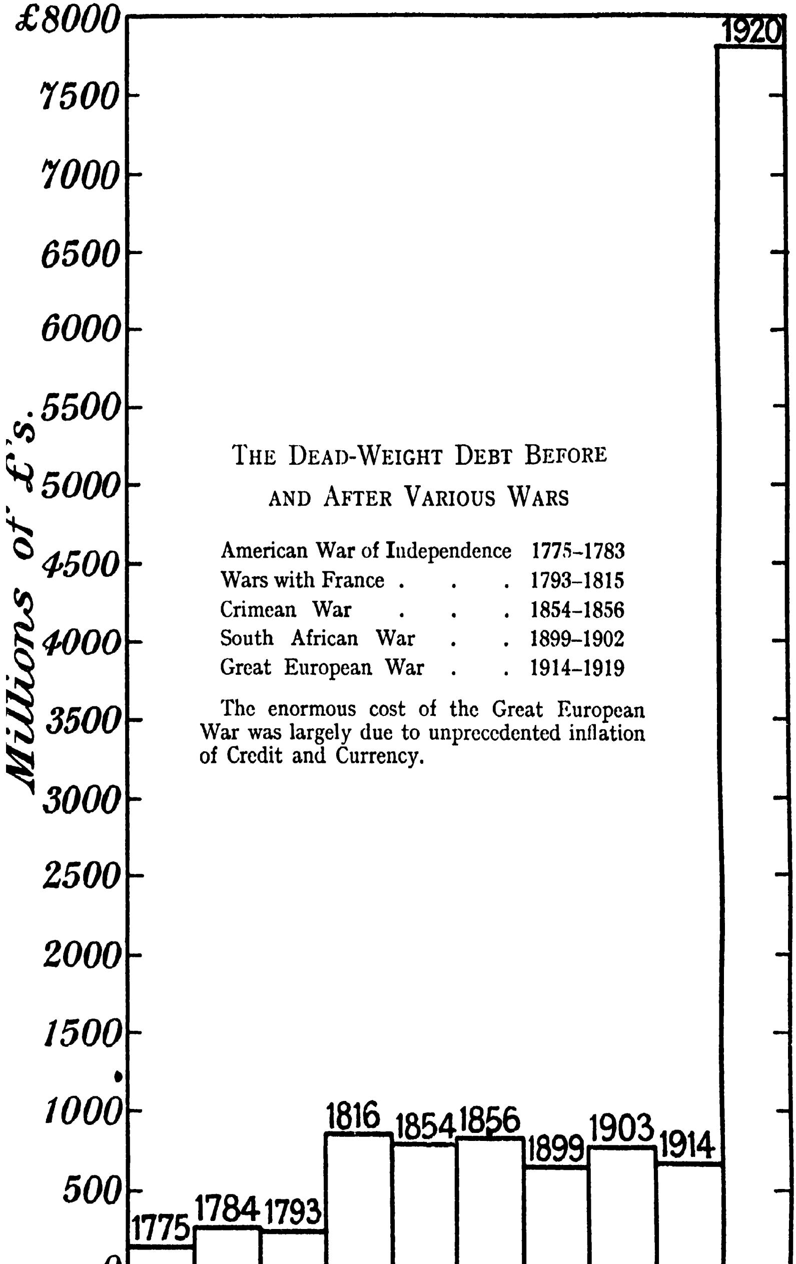
THE DEAD-WEIGHT DEBT BEFORE AND AFTER VARIOUS WARS

		£
1688	The "King's Debt," incorporated by William III (contracted by Charles II and James II) . .	664,000
	(Between 1688 and 1775 various wars with France and Spain increased the National Debt by about £128,000,000)	
1775	Commencement of American War of Independence (France and Spain also fought against England) .	128,584,000
1784	Year after conclusion of above war . . .	250,000,000
1793	Commencement of Wars with France . . .	239,000,000
1816	Year after conclusion of above wars . . .	846,000,000
1854	Commencement of Crimean War	795,000,000
1856	Conclusion of above war	826,000,000
1899	Commencement of South African War . .	628,000,000
1903	Year after Conclusion of above war . . .	771,000,000
1914	Commencement of Great European War . .	651,000,000
1915	. . . .	1,109,000,000
1916	. . . .	2,141,000,000
1917	. . . .	4,011,000,000
1918	. . . .	5,872,000,000
1919	. . . .	7,435,000,000
1920	Year after conclusion of above war . . .	7,829,000,000
1921	. . . .	7,573,000,000

The dead-weight debt, it is to be noted, differs little from the total National Debt. At 31st March, 1919, the aggregate gross liabilities of the State were £7,481,000,000, of which £7,435,000,000 represented the dead-weight debt, and £46,000,000 "Other Capital Liabilities" in respect of sums borrowed under various Acts. At 31st March, 1914, the "Other Capital Liabilities" amounted to £56,000,000. It was not until 1891 that such liabilities exceeded £1,000,000. Against these liabilities the State holds certain assets, and has also an asset in its holding of Suez Canal shares, the market value of which was £32,818,000 at 31st March, 1919.



THE DEAD-WEIGHT DEBT AT FISCAL YEAR ENDS
31ST MARCH


£8000
7500
7000
6500
6000
5500
5000
4500
4000
3500
3000
2500
2000
1500
1000
500
0
Millions of £'s.
THE DEAD-WEIGHT DEBT BEFORE AND AFTER VARIOUS WARS
American War of Independence 1775–1783
Wars with France . . . 1793–1815
Crimean War . . . 1854–1856
South African War . . 1899–1902
Great European War . . 1914–1919
The enormous cost of the Great European War was largely due to unprecedented inflation of Credit and Currency.
1775
1784
1793
1816
1854
1856
1899
1903
1914
1920

CHAPTER IX

THE ECONOMIC PROBLEM OF SUPPLIES

WHEN future historians come to write a complete account of the Great War, they will doubtless agree that superiority in supplies exercised a considerable influence in deciding the final issue of the conflict. The calls on productive power increased so rapidly during hostilities, that the war largely resolved itself into a conflict between economic forces. It is obvious that the limit of economic endurance depends not only on the amount of available resources, but also on the proper application of the resources.

Modern warfare demands the expenditure of a vast amount of heavy munitions of war. An enormous transport organization is required to bring munitions and foodstuffs within reach of the fighting forces. To make the transport facilities effective at all parts of the fighting front, new railways, bridges, and roads have to be constructed on an unprecedented scale, as near to the positions of the army and guns as possible. A great transport organization necessarily makes heavy demands on rolling stock and transport vehicles of all types. Moreover, the recent war introduced numerous new engines of destruction, all of which consume a vast amount of labour in their production. In fact, so great was the economic strain caused by the recent war, particularly during its third year, that it severely taxed the productive power of the whole world to keep pace with its requirements.

National energy in war time is absorbed in six main channels, namely—

1. Fighting forces and services accessory to fighting.
2. Warships and mercantile ships.
3. Munitions and transport material.
4. Food and clothing for those engaged in fighting or performing services accessory to fighting.
5. Food and clothing for the civilian population.
6. Manufacturing articles for export for indirect exchange of those enumerated under 3, 4, and 5.

All these six factors tend to compete with one another in their

demands on labour and material resources, and call for the most scientific mobilization of labour and economy in resources. Warfare demands increased national production and reduced consumption by the civilian population.

During the third year of war there was undoubtedly a national awakening to the importance to be attached to the economic as well as to the military and naval conflict. The early months of this year of war were marked by an insistent public call for more energetic action of every kind by the Government in the prosecution of the war and the exercise of economy with regard to the national resources. It was the recognition of the fact that the United Kingdom had not hitherto during the war put forth the maximum amount of energy, combined with the most skilful mobilization of resources, of which she was capable, that was one of the main causes that led to the downfall of the Ministry in early December, 1916.

The new Prime Minister (Mr. Lloyd George), in a speech defining his war policy, stated in the House of Commons on Tuesday, 19th December, that the task of the Government was to complete and make even more effective the mobilization of all our resources. He also announced that the War Cabinet had decided that the time had come for adopting the principle of universal national service, and that a Director-General of National Service had been appointed. The intention was that labour should be set free from non-essential industries and be invited to enrol for war work. In a reference to shipping, the Prime Minister stated that the time had come to take more complete control over all ships and to place them practically in the same position as the railways. With regard to mines, he announced that the Government felt that they ought to assume a more direct control over the whole mining industry—an industry which was absolutely indispensable to the effective carrying on of the war. In the matter of food, he announced that "over-consumption by the fortunate must not be allowed to create a shortage for the less well-to-do"; and that when we come to production, "every available square yard must be made to produce food."

Notwithstanding that the new Ministry commenced office with such good resolutions, it was during the remainder of the war only partly successful, from an economic standpoint, in its foremost

resolution, "to complete and make even more effective the mobilization of all our resources."

Each successive Ministry during the war failed to realize that if the needs of a great army in war time are to be adequately supplied, the civilian population must be made not only to increase production, but to reduce its pre-war standard of comfort and amusement. It is quite as much the duty of the Government of a country at war to compel civilians to work harder and practise self-denial, as it is to call upon fit men of military age for fighting purposes, often to make the supreme sacrifice. Drastic economy admittedly means individual inconvenience, and even suffering; but these are small sacrifices compared with those that have to be borne by the fighting forces. During its tenure of office the new Ministry issued innumerable orders, in an endeavour to increase production, to reduce consumption in certain articles, to stop speculation in commodities, to stop excessive profits arising out of trading in the necessaries of life, and for other economic objects, including severe restrictions on the import of many classes of articles, save under special licences, with the avowed intention of reserving mercantile tonnage for the carriage of more essential goods. The main point for economic criticism is that the Government during the war was not sufficiently drastic in its measures to enforce material and equitable reduction in consumption of goods and services, and diversion of labour from unnecessary to necessary production and services. War conditions demand fighting men, goods, and services: all other factors are of secondary importance.

On the other hand, it has to be recognized that the suddenness of the outbreak of war and its magnitude did not permit of such close control of public expenditure as in pre-war times, and therefore the careful husbanding of the economic resources of the country. Part of such resources were dissipated by unnecessary or ill-advised expenditure of the Government. Again, war expenditure created artificial prosperity, which spread in an ever-widening circle, and rendered it exceedingly difficult to introduce measures to restrict effectively civilian consumption.

The best proof of the enormous strain imposed on the productive capacity of the United Kingdom during the recent war is given by the official figures showing the number of men that passed through the ranks of the British Army during the war. (The

population of the United Kingdom in 1914 was about 46,000,000.) Between 4th August, 1914, and 11th November, 1918 (the Declaration of War and the signing of the Armistice) more than 6,000,000 men passed through the ranks of the British Army in France. When all is counted up, the total number of troops from Britain and her Overseas Dominions employed in the War was 8,654,467, divided thus—

British Isles	5,704,416
Canada	640,886
Australia	416,809
New Zealand	220,099
South Africa	136,070
India	1,401,350
Other Colonies	134,837

The total casualties exceeded 3,000,000—

Killed	851,117
Missing and Prisoners	142,057
Wounded	2,067,442

Of these, Great Britain's total was 662,083 killed, 140,312 missing and prisoners, and 1,644,786 wounded.

Admittedly, the United Kingdom obtained very large supplies of war materials from the United States of America, but, on the other hand, she furnished her Allies with enormous supplies of all classes of materials, a measure of which is given by the amount of her loans to her Allies. (See Chapter VI, on "Government Borrowings.")

One of the greatest economic strains felt by Great Britain during the war was the submarine campaign by Germany on merchant shipping. Germany announced on 1st February, 1917, that she would henceforth sink, without warning, every vessel (including those of neutral countries) which she found in certain designated barred zones. This campaign met with only a limited amount of success, reaching its maximum in April, 1917, the British shipping gross losses for this month being 560,000 tons. In the middle of October, 1919, the Admiralty issued a final return of British merchant shipping lost during the war through enemy action. From August, 1914, up to the Armistice day (11th November, 1918) 2,479 merchant vessels of gross tonnage of 7,759,090 tons were actually lost. Of this total, enemy submarines accounted for 2,099 vessels of 6,635,059 gross tonnage, mines, 259 vessels of

673,417 tons, the remainder being sunk by cruisers, torpedo-boats, etc., and aircraft. The number of lives lost in these vessels totalled 14,287. In addition to this, 675 fishing vessels were lost, of 71,765 gross tonnage, 434 men losing their lives. Exclusive of these figures, there was an enormous number of British merchant vessels " damaged or molested, but not sunk." The total in this class was 1,885 vessels, of gross tonnage of no less than 8,007,967 tons, entailing a loss of 592 lives.

Notwithstanding the serious gross losses in tonnage, the actual net loss, owing to building of new ships, purchase from neutrals, and captures from the enemy, was much less. According to Lloyd's Register, the gross steam tonnage of the United Kingdom in June, 1914, was 18,892,000 tons. In June, 1919, it was 16,345,000 tons—a reduction of 2,547,000 tons, or 13·5 per cent. During the same period the United States of America increased her sea-going steam tonnage from 2,027,000 to 9,773,000 tons—an increase of 7,746,000 tons, or 382 per cent. The shipbuilding returns for 1919 showed that the United Kingdom's output of mercantile vessels during the year was 612, representing 1,620,442 tons. This total was 272,322 tons better than the 1918 total.

In June, 1921, the world's total sea-going steel and iron steam tonnage was 54,217,000 tons, an increase of 11,703,000 tons as compared with the total in June, 1914. According to Lloyd's Register this increase was made up as follows—

	Tons.
Increase in the United Kingdom	411,000
Increase in the United States	10,477,000
Increase in other countries	6,311,000
Total	17,199,000
Loss to Germany	4,444,000
Ex-Austro-Hungarian tonnage	1,052,000
Total	5,496,000
Net world's increase	11,703,000

In the case of the United Kingdom, France and Italy, the present tonnage includes a considerable amount of ex-enemy tonnage allocated under the terms of the Peace Treaty. In June, 1914, the United Kingdom owned 44.4 per cent. of the world's steam tonnage, but in June, 1921, the percentage had fallen to 35·6.

That the final issue of the war would be largely determined by superiority in supplies was clearly recognized by the United States of America on her entry into the war. The United States declared war on Germany on 5th April, 1917,[1] on account of the submarine campaign of the latter. Eleven days later, on 16th April, 1917, President Wilson issued the following strong appeal to all American citizens. It displays a very close grip of economic problems under conditions of war. The President clearly perceived that industrial, agricultural, and economic problems must first be solved if naval and military forces were to have the opportunity of victory. The entry of the United States into the war enormously strengthened the economic resources of the Allies.

PRESIDENT WILSON'S APPEAL TO AMERICAN CITIZENS

FELLOW-COUNTRYMEN,—The entrance of our beloved country into the grim and terrible war for democracy and human rights, which has shaken the world, creates so many problems of national life and action which call for immediate consideration and settlement, that I hope you will permit me to address you a few words of earnest counsel and appeal with regard to them.

We are rapidly putting our Navy upon an effective war footing, and are about to create and equip a great Army, but these are simply parts of the great task to which we have addressed ourselves. There is not a single selfish element, so far as I can see, in the cause we are fighting for. We are fighting for what we believe and wish to be the rights of mankind and the future peace and security of the world. To do this great thing worthily and successfully we must devote ourselves to service without regard to profit or material advantage, and with an energy and intelligence that rise to the level of the enterprise itself. We must realize to the full how great the task is, how many things, how many kinds of elements of capacity, service, and self-sacrifice it involves.

THE THINGS TO DO WELL

These, then, are the things we must do, and do well, besides fighting—the things without which mere fighting would be fruitless.

We must supply abundant food, not only for ourselves, and for our Armies and our seamen, but also for a large part of the nations with whom we have now made common cause, in whose support and by whose sides we shall be fighting.

We must supply ships by hundreds out of our shipyards to carry to the other side of the sea—submarines or no submarines—what will every day be needed there, and abundant materials out of our fields, mines, and factories, with which, not only to clothe and equip our own forces on land and sea, but also to clothe and support our people for whom the gallant fellows under arms can no longer work; to help clothe and equip the Armies with which we are co-operating in Europe; and to keep the looms and manufactories there in raw material—coal to keep the fires going in ships at sea, and the furnaces in hundreds of factories across the sea: steel out of which to make arms and ammunition both here and there: rails for

[1] Diplomatic relations between the two countries had been severed by the United States since 3rd February, 1917.

worn-out railways at the back of the fighting fronts: locomotives and rolling-stock to take the place of those every day going to pieces: mules and horses and cattle for military service—everything with which the people of England, France, Italy, and Russia have usually supplied themselves, but cannot now afford the men, materials, or machinery to make.

It is evident to every thinking man that our industries on farms, in shipyards, mines, and factories must be made more prolific, and more efficient than ever, and must be more economically managed, and better adapted to the particular requirements of our task than they have been; and what I want to say is that men and women who devote their thought and energy to these things will be serving their country and conducting the fight for peace and freedom just as truly and just as effectively as men on the battlefield or in the trenches. The industrial forces of the country, men and women alike, will be a great international service army—a notable honoured host engaged in the service of the nation and the world, the efficient friends and saviours of free men everywhere. Thousands, nay hundreds of thousands of men, otherwise liable to military service, will, of right and necessity be excused that service and assigned the fundamental sustaining work of fields, factories, and mines; and they will be as much part of the great patriotic forces of the nation as the men under fire.

Food and the Fate of Nations

I take the liberty, therefore, of addressing this word to the farmers of the country and all those who work on farms. *The supreme need of our own nation, and of the nations with whom we are co-operating, is an abundance of supplies, especially foodstuffs.* The importance of an adequate food supply in the present year is superlative. Without abundant food, alike for the Armies and people now at war, the whole great enterprise upon which we have embarked would break down and fail. The world's food reserves are low. Not only during the present emergency, but for some time after peace shall have come, both our own people and a large proportion of the people of Europe must rely on the harvests of America. Upon the farmers of this country, therefore, in a large measure rests the fate of the war—the fate of nations. May the nation not count upon them to omit no step that will increase the production of their land, or bring about the most effectual co-operation in the sale and distribution of their products?

The time is short, and it is of the most imperative importance that everything possible be done, and done immediately, to make sure of large harvests. The call upon young men and old alike, and upon able-bodied boys on the land to accept and act upon this duty—to turn in hosts to the farms to make certain no pains and no labour are lacking in this great matter. I particularly appeal to farmers in the South to plant abundant foodstuffs as well as cotton. They can show their patriotism in no better and more convincing way than by resisting the great temptation to the present price of cotton, and by helping upon a great scale to feed the nation and peoples everywhere who are fighting for their liberties and our own. The variety of their crops will be a visible measure of their comprehension of their national duty.

A Call to Middlemen

The Government of the United States and the Governments of several States stand ready to co-operate. They will do everything possible to assist farmers in securing an adequate supply of seed, an adequate force of labourers when they are most needed at harvest time, and means for expediting the shipments of fertilizers and farm machinery, as well as the crops themselves when they are harvested. The course of trade shall be as unhampered as it is possible to make it, and there shall be no unwarranted manipulation of the nation's food supply by those who handle it on its way to the consumer. This is our opportunity to demonstrate the efficiency of

a great Democracy, and we shall not fall short in this. Let me say to middlemen of every sort, whether they are handling our foodstuffs, our raw materials of manufacture, or the products of our mills and factories: the eyes of the country will be especially upon you. This is your opportunity for signal service, efficient, and disinterested. The country expects you, as it expects all others, to forego unusual profits, to organize and expedite the shipment of supplies of every kind, but especially food, with an eye to the service you are rendering and in the spirit of those who enlist in the ranks for their people not for themselves. I shall confidently expect you to deserve and win the confidence of the people of every sort and station.

To men who run the railways of the country, whether they be managers or operative employees, let me say that railways are the arteries of the nation's life, and that upon them rests the immense responsibility of seeing to it that these arteries suffer no obstruction of any kind through inefficiency or slackening of power. To the merchants, let me suggest the motto: "Small Profit, Quick Service"; and to the shipbuilder, the thought that life and war depend upon him. Food and war supplies must be carried across the seas, no matter how many ships are sent to the bottom. The places of those that go down must be supplied—and supplied at once. To the miner, let me say that he stands where the farmer does. The work of a world waits on him, and if he slackens or fails, armies and statesmen are helpless. He also is enlisted in the great service of the army. The manufacturer does not need to be told, I hope, that the nation looks to him to speed and perfect every process, and I want only to remind his employees that their service is absolutely indispensable, and is counted on by every man who loves this country and its liberties.

No Time for Extravagance

Let me suggest also that every one who creates and cultivates a garden helps to solve the problem of feeding the nations, and every housewife who practises strict economy puts herself in the ranks of those who serve the nation. This is the time for America to correct her unpardonable fault of wastefulness and extravagance. Let every man and every woman assume a duty—the careful and provident use of expenditure as a public duty, and as the dictate of patriotism which none can now expect ever to be excused or forgiven for ignoring.

In the hope that this statement of the needs of the nation and the world in the hour of supreme crisis may stimulate those to whom it comes, and remind all, who need a reminder, of the solemn duties of a time such as the world has never seen before, I beg that all editors and publishers everywhere will give as prominent a publication and wide circulation as possible of this appeal, and I venture to suggest also to all advertisement agencies that they would perhaps render a very substantial and timely service to the country if they would give it widespread repetition, and to clergymen not to think it an unworthy or inappropriate subject of comment and homily for their pulpits. The supreme test of the nation has come, and we must all speak, act, and serve together.

CHAPTER X

COMMODITY PRICES—ECONOMIC INFLUENCES

In any analysis of the factors that cause variation in prices of commodities, two sets of variable influences have necessarily to be considered, the first—Economic, the second—Monetary; in other words, the quantity of goods on sale and the purchasing power of the community. In the present chapter there will be considered only the economic factors (but including psychological influences, increased taxation, and adverse exchanges) that gave rise to the great increase in prices during and since the war, up to April, 1920; the monetary factors—the more important—being considered at length in the next chapter. Some reasons will also be advanced for the partial fall that has taken place since April, 1920.

Index Numbers. Before either set of factors are considered at length it will be advisable to have a clear conception of what is meant by an "Index Number" in relation to commodity prices, for some confusion occasionally arises from the different senses in which the term "Index Number" is used. Index numbers are numbers which measure the average price variation of a number of commodities. They are, of course, relative numbers. The word "weight," sometimes used in relation to index numbers, refers to the extent to which price variations in particular commodities are allowed to affect the average price variation of the commodities as a whole. To obtain an index number accurately representing variation in prices is, in practice, impossible. Such a number would obviously have to be based on a consumption standard. The theoretical basis of a consumption standard is that the true measure in the change of the value of money is the change in the amount of currency that must be paid by consumers throughout the country for all commodities in their finished state consumed by them per unit of time. No trustworthy figures being available for the retail prices of the commodities actually consumed, it is usual to take certain foodstuffs and materials as typical of these commodities, and to assume that, roughly speaking, the changes in the

prices of these raw materials, although usually more rapid and violent than the changes in prices of the manufactured articles consumed, do—on the whole—over relatively long periods of time, afford a fair measure of these changes. It is sometimes contended that an ideal consumption index number should not only be based on retail prices of commodities actually consumed in unit time, but its constituents should include the cost of rent, rates, professional and other services. The only answer to this contention is that it is impossible to include such items. Considerations such as these, whilst they impair the exactness of any deductions made from index numbers, do not detract from the general conclusions deduced from the quite considerable movement of these numbers. They do, however, suggest the question whether there is any utility in devising an exact system of weighting, having regard to the necessarily somewhat rough character of the results. Obviously, an exact system of weighting based on the extent to which the commodities are consumed in unit time would have to take due account of the varying relative importance of different commodities at different times, an almost impossible calculation.

The best-known index numbers are not weighted according to any exact principle. They are usually only roughly weighted by taking into the calculation either two or more varieties of the same article, or the same article in different stages of manufacture. It is, in fact, found in practice that the main bulk of wholesale prices do, as a rule, move in much the same direction, although at varying rates. Except under abnormal circumstances, there is agreement in the general tendency of curves plotted from the various index numbers in common use. When, however, the general trend of prices is interrupted violently by circumstances of a special character, as is the case during great wars, certain articles are often more affected than others, and therefore the weighting of the prices of such articles may have an appreciable effect on the resultant general index number. This is all the more noticeable when circumstances occur affecting to a great degree the price of one particular article, as, for instance, the price of cotton during the American Civil War.

Two of the best-known index numbers in use in the United Kingdom at the present time are those calculated and published monthly by *The Statist* and *The Economist* respectively.

The index numbers calculated monthly and yearly by *The Statist* are in continuation of those formerly calculated by Mr. Sauerbeck for the period 1846–1912. This index number is based on wholesale price variations of 45 commodities (foodstuffs and materials), some of the more important articles being represented by two descriptions, in all 13. In a foot-note to a chart published in 1908, Mr. Sauerbeck stated his index numbers had been constructed as follows: The average prices of the 11 years, 1867–1877, were called 100 in the case of each commodity, and the percentage variation was calculated for each year. The percentage variation figures of all the articles were next added together for each year and divided by the total number of commodities, and the figure thus obtained formed the index number for the respective year. For instance, the percentage variations for 1907 totalled to 3,588. Dividing this total by the number of commodities, 45, there was derived 80 as the index number for 1907. This index number is, therefore, the arithmetical mean of the percentage variations, all articles being considered as of equal value.

The index number calculated at the end of each month by *The Economist* is, like that of Mr. Sauerbeck, based on percentage wholesale price variations of important commodities, the number of commodities, together with the number of varieties, taken by *The Economist* being 44, as against 58 by Mr. Sauerbeck. The index number of *The Economist* consists of the total of the percentage variations, and not such total divided by the number of commodities entering into the calculation, as in the case of Mr. Sauerbeck's number. The basis taken by *The Economist* is the average of prices ruling during the six years 1901–1905, the basic index number being 2,200 (Cereals and meat, 500; other food products (tea, sugar, etc.), 300; textiles, 500; minerals, 400; miscellaneous (rubber, timber, oils, etc.), 500; total, 2,200).

A third index number available, and one also intended to represent the course of wholesale prices, is that which has been calculated by the Board of Trade since 1871. Until the end of 1920, this index was a compound number weighted according to the considered relative importance of the various articles in the business of the country. At the commencement of 1921, the Board of Trade decided to change completely the basis on which this index number had hitherto been calculated, giving as the

reason for the change that it was anticipated that the new number would reflect more closely than had been the case with the old number in the recent past the movements of the wholesale markets, the special conditions of trade during and since the war having had the effect of diminishing in this respect the value of the number as hitherto calculated.

After the foregoing remarks on the nature and value of index numbers, the course of commodity prices during and since the recent war may be considered in detail. Below there is given a table showing the index numbers prepared by *The Statist* and *The Economist* to represent price variations of wholesale commodities for each month since January, 1914, and up to May, 1921.

END OF MONTH INDEX NUMBERS OF *THE STATIST* AND *THE ECONOMIST*

	Jan.	Feb.	Mar.	April.	May.	June.	July.	Aug.	Sept.	Oct.	Nov.	Dec.
Statist—												
1914 . .	83·5	83·8	82·8	82·3	82·3	81·2	82·4	87·9	89·3	89·8	88·8	91·6
1915 . .	96·4	100·9	103·7	105·9	107·2	106·4	106·4	107·0	107·8	110·0	113·1	118·4
1916 . .	123·6	127·0	130·4	134·2	135·4	131·0	130·5	134·5	134·3	141·5	150·8	154·3
1917 . .	159·3	164·0	169·0	173·0	175·0	180·4	176·9	175·7	176·4	180·6	182·9	185·1
1918 . .	186·2	187·3	188·0	189·8	191·1	192·3	192·9	195·9	197·1	197·8	195·3	196·0
1919 . .	192·1	187·5	184·7	184·6	194·6	199·4	206·4	212·7	214·8	224·3	231·0	235·2
1920 . .	245·3	260·4	261·8	266·1	260·0	255·7	254·5	253·5	248·7	239·9	223·8	207·2
1921 . .	197·2	183·0	177·2	169·8	162·2							
Economist—												
1914 . .	2,618	2,616	2,597	2,585	2,595	2,549	2,565	2,698	2,780	2,732	2,760	2,800
1915 . .	3,003	3,131	3,305	3,327	3,327	3,250	3,281	3,296	3,336	3,371	3,500	3,634
1916 . .	3,840	4,008	4,013	4,190	4,319	4,213	4,204	4,372	4,423	4,596	4,779	4,908
1917 . .	4,953	5,072	5,300	5,379	5,412	5,646	5,589	5,658	5,634	5,701	5,768	5,845
1918 . .	5,785	5,818	5,867	5,941	6,016	6,105	6,128	6,267	6,238	6,210	6,212	6,094
1919 . .	5,851	5,796	5,708	5,774	5,988	6,188	6,450	6,503	6,587	6,795	6,985	7,364
1920 . .	7,768	8,160	8,352	8,232	8,199	7,847	7,876	7,743	7,645	7,175	6,594	5,924
1921 . .	5,617	5,176	5,097	4,929	4,910							

(Up to June, 1914, the Index Numbers shown of *The Economist* are based on prices ruling on the 1st day of the following month.)

Inset there is shown a graphical representation of the course of these monthly index numbers, the curves of which, though not in exact agreement, are in very close agreement. To indicate clearly to the eye the close correspondence between the two curves, the index number of *The Statist* for each month has been multiplied by three, and that of *The Economist* has been divided by ten, before plotting the relative curves. The chart clearly shows that there took place an almost continuous rise in the prices of wholesale commodities from the Declaration of War at the commencement of August, 1914, until about the Armistice with Germany on 11th November, 1918. Thereafter, there was a small fall until

April, 1919 (Peace with Germany, 28th June, 1919), which was followed by a very rapid rise until April, 1920, from which date there has taken place an almost continuous fall. The curve representing the index number of *The Economist* reached its maximum apex at the end of March, 1920, and that for *The Statist* a month later.

Between the end of June, 1914, and the end of October, 1918 (Armistice with Germany, 11th November, 1918), *The Statist* index number increased 144 per cent., and that of *The Economist* 144 per cent. Between the end of June, 1914, and the end of June, 1919 (Peace signed with Germany, 28th June, 1919), *The Statist* index number increased 145 per cent., and that of *The Economist* 143 per cent. Between the end of June, 1914, and the end of March, 1920, *The Statist* index number increased 222 per cent., and that of *The Economist* 228 per cent. Since the end of March, 1920, and up to the end of May, 1921, *The Statist* index number has fallen 38 per cent., and that of *The Economist* 41 per cent. The table of index numbers shows that even the gathering war-clouds during July, 1914, caused a slight increase in the price of wholesale commodities for that month.

The relative part played by the price variations of the various groups of commodities which enter into the composite index number of *The Economist* is shown by the following table, the index number for each group at the commencement of July, 1914, being represented by 100—

PERCENTAGE VARIATIONS OF INDEX NUMBERS OF GROUPS OF COMMODITIES. (*The Economist*)

	Cereals and Meat.	Other Foods.	Textiles.	Minerals.	Miscellaneous.	Composite Index Number.
1st July, 1914	100	100	100	100	100	100
End Oct., 1918[1]	225	226	307	186	253	244
End June, 1919[2]	237	232	283	199	249	243
End Mar., 1920	267	265	483	264	310	328[3]
End Dec., 1920	238	233	208	258	231	232
End Jan., 1921	229	231	193	239	219	220
End Feb., 1921	208	223	169	223	206	203
End Mar., 1921	214	211	167	213	204	200
End Apr., 1921	211	210	167	199	189	193
End May, 1921	211	200	162	204	193	193

[1] Armistice with Germany, 11th November, 1918.
[2] Peace signed with Germany, 28th June, 1919.
[3] Highest index number ever recorded.

As there were special influences affecting different groups in varying degrees at different times, and some articles were for a period controlled or purchased and distributed by the Government, the divergence in the percentages shown in the foregoing table was to be expected under the circumstances.

It will be observed from the percentages that from 1st July, 1914, the greatest rise, up to March, 1920, took place in the textile group, and, as was to be expected, the greatest fall from that date up to the end of May, 1921, took place in the same group. (The textile group includes cotton, yarn, cloth, wool, silk, flax, hemp, and jute.) Some varieties of cotton, wool, and piece goods had fallen 60 to 80 by April, 1921. The group percentages also show that wholesale prices about the date Peace was signed with Germany differed little from prices ruling about the date of the Armistice, nearly eight months previously.

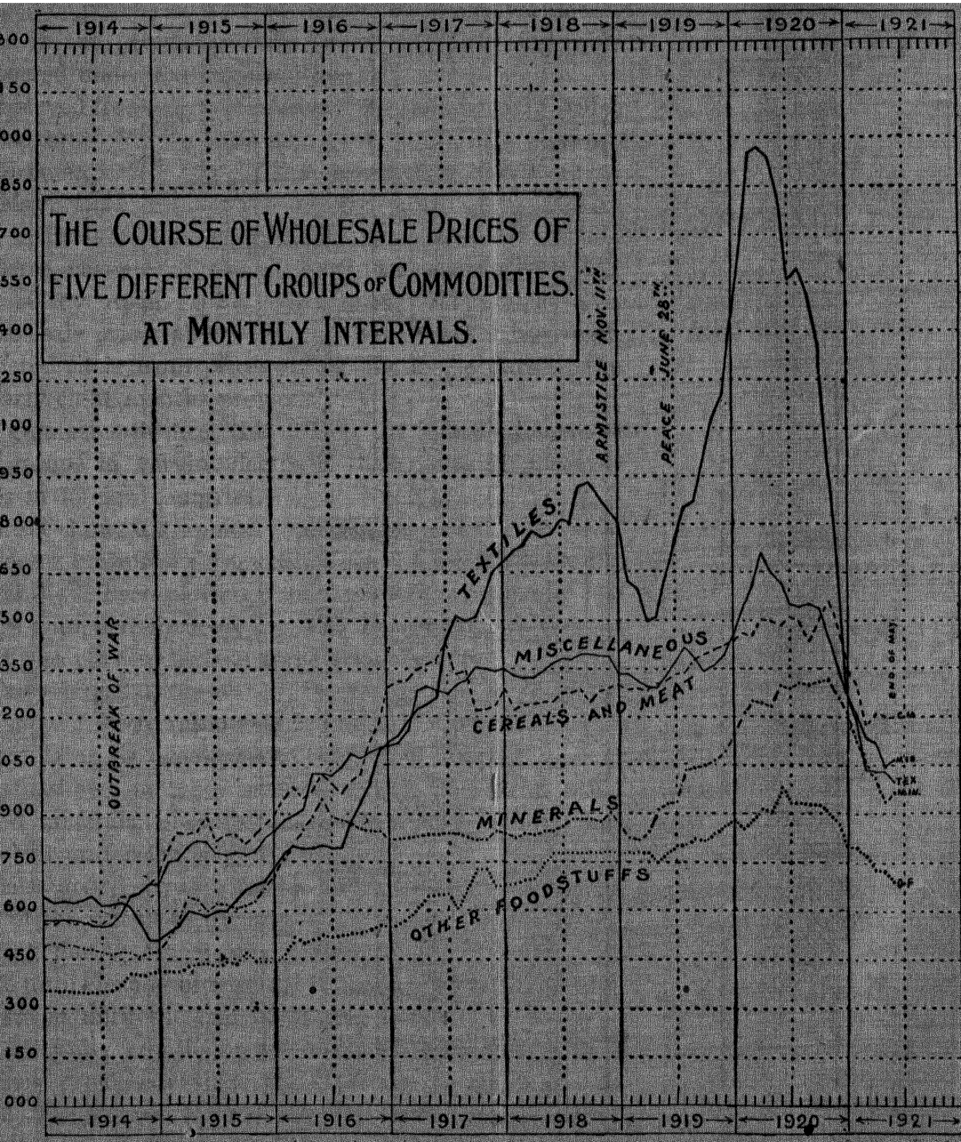
One of the greatest influences that affects the index numbers of the different groups in varying degree is the course of prices of similar groups in foreign countries.

The chart inset shows a graphical representation of the course of prices for different groups of commodities since January, 1914, the curves of which have been plotted from the index numbers for the several groups compiled monthly by *The Economist.* It will be observed that the curves disclose three main features, namely—

1. In the early stages of the war all the five groups of wholesale commodities show a fairly rapid rise in prices.

2. The effect later of Government control of supplies and of prices is clearly shown in three groups—cereals and meat, other foodstuffs, and minerals, notwithstanding that this country was largely dependent on foreign sources of supply.

3. The textiles group shows a fall in prices from a month after the outbreak of the war until the end of December, 1914. Thereafter (excepting during March-July, 1916) an almost continuous rise took place until the end of September, 1918. After this month a rapid fall set in until the end of March, 1919, to be followed during the next twelve months by a rise considerably greater than had taken place previously since the outbreak of the war. At 1st July, 1914, *The Economist* index number for the textiles group was 616; at the end of March, 1919, it was 1,502, a difference of 886; but at the end of March, 1920, it was 2,974½, a further difference



THE ABOVE CURVES HAVE BEEN PLOTTED FROM THE GROUP INDEX NUMBERS PUBLISHED MONTHLY BY THE "ECONOMIST"

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of 1,472½. Since the latter date the chart clearly shows that textile prices have fallen considerably, the index number at the end of May, 1921, being 996 as against 2,974½ at the end of March, 1920.

So great and rapid has been the reaction in textile prices since April, 1920, that the percentage increase remaining at the end of May, 1921, over the level ruling at 1st July, 1914, was materially less than the increase at the same date for any of the other groups. Consequently, any further fall in textile prices will probably be relatively of slower movement than further falls in the price levels of the other groups.

The course of the textiles group curve on the chart clearly discloses the very unhealthy and dangerous price position created in the textile trades from about July, 1919, through unbridled competition for available supplies, and indicates that every trader and manufacturer in this group should have been on his guard against being caught with heavy stocks or liability to accept high-priced goods when the inevitable slump later set in. Since the outbreak of the recent war, the textiles trades appear to have been more subject to psychological influences than any other trades. During September–December, 1914, the textiles group index number fell from 626 to 509, through groundless fear of bad trade. Another severe fall commenced in October, 1918, when it became evident that Germany would shortly be suing for an Armistice; the textiles group index number between the end of September, 1918, and the end of March, 1919, falling from 1,929 to 1,502. From April, 1919 (when peace was practically assured), an opinion became general in the textiles trades, not only at home but abroad, that the world, particularly the Continent, was exceptionally short of clothing as a consequence of the five years' war, and that there would arise a great and prolonged world-wide demand for all classes of clothing, almost regardless of price. So strong and general was this opinion that merchants, in many cases, contracted for supplies as far as twelve months ahead. The reaction set in when it became evident, first, that apart from the Central Powers and Russia, the world was not so short of clothing as had been anticipated; second, the necessity of the masses economizing in clothing on account of high cost of other and more essential commodities, and increased taxation; and third, the revolt of the consumer at prices for

clothing ranging from 300 to 400 per cent. above pre-war prices.

As is well known, the great rise in commodity prices since the commencement of the recent war, and up to the early months of 1920, was not confined to the United Kingdom; the rise was almost world-wide, varying in degree in different countries according

INTERNATIONAL WHOLESALE PRICES.[1]
INDEX NUMBERS EXPRESSED AS PERCENTAGES OF 1913.

Period.	United Kingdom.			Canada	United States of America.		France.	Italy.[3]	Japan.	Sweden
	Board of Trade.[2]	*Economist.*	*Statist.*	Official.	Bureau of Labour	Brad-Street.	*Statistique Générale.*	*Bachi.*	Bank of Japan, Tokyo.	*Svensk Handelstidning.*
Average.										
1913 . .	100·0	100·0	100·0	100·0	100	100·0	100·0	100·0	100·0	100
1914 . .	100·6	98·7	101·2	100·4	99	97·0	102·6	95·1	95·5	116
1915 . .	123·5	123·1	125·8	109·2	100	108·1	140·9	132·7	96·7	145
1916 . .	160·1	160·5	159·5	134·3	123	130·0	189·6	199·7	117·2	185
1917 . .	208·6	204·1	206·1	174·9	175	172·2	262·6	306·3	148·5	244
1918 . .	229·5	224·9	226·5	205·4	196	204·0	340·9	409·1	195·9	339
1919 . .	254·5	235·2	241·9	216·4	212	204·0	358·3	365·8	239·5	330
1920 . .	318·8	283·2	291·8	246·2	244	201·3	512 0	624·4	259·6	347
1919 July.	241·7	239 6	242·8	217·0	219	217·7	350·4	362·4	247·2	320
Aug..	257·3	241·5	250·2	222·2	226	212·0	349·3	369·4	251·3	321
Sept..	264·5	244·6	252·7	222·5	221	212·5	361·9	371·7	257·6	319
Oct. .	277·9	252·4	263·9	221·1	223	216·7	383·8	390·5	266·3	307
Nov.	288·9	259·4	271·8	227·1	230	219·6	407·1	438·8	280·0	308
Dec. .	296·8	273·5	276·7	237·8	238	221·7	424·9	457·3	288·6	317
1920 Jan. .	306·1	288·5	288·6	248·3	248	227·2	489·3	503·7	301·1	319
Feb. .	316·4	303·1	306·3	253·5	249	226·4	524·6	556·3	313·6	342
Mar..	322·1	310·2	308·0	257·6	253	225·5	557·4	619·0	321·6	354
April	321·4	305·7	313·1	260·6	265	225·7	590·6	679·1	300·5	354
May .	319·2	304·5	305·9	263·2	272	216·4	553·0	659 0	272·1	361
June	337·8	291·4	300·8	257·8	269	210·7	495·3	614·8	247·9	366
July.	347·0	292·5	299·5	255·9	262	205·0	498·2	613·0	239·5	363
Aug.	325·7	287·6	298·2	243·7	250	195·7	503·9	631·7	235·2	365
Sept.	330·8	283·9	292·6	241·0	242	184·1	528·4	660·5	230·7	362
Oct.	324·0	266·5	282·2	234·4	225	170·6	504·3	662·1	225·8	346
Nov.	312·7	244·9	263·3	224·5	207	148·3	463·1	658·0	221·4	331
Dec.	302·3	220·0	243·8	214·4	189	137·8	437·0	635·4	205·7	299
1921 Jan.	—	208·6	232·0	207·6	177	134·6	408·7	—	201·1	267
Feb.	—	192·2	215·3	199·3	167	129·2	379·4	—	195·2	250
Mar.	—	189·3	208·5	194·2	162	123·8	361·7	—	191·0	237
April	—	183·8	199·8	188·7	154	117·8	349·0	—	189·9	229

to conditions more or less peculiar to each country. In the table given above, index numbers, expressed as percentages of 1913, representing wholesale prices in the United Kingdom, are compared with relative percentages in Canada, the United States, France, Italy, Japan, and Sweden. A study of the percentages discloses that wholesale prices up to April, 1920 (*Economist*), rose more in the United Kingdom than in the United States (*Bradstreet*), but less

[1] As tabulated in *Monthly Bulletin of Statistics* published by the Supreme Economic Council.

[2] From January, 1921, the Board of Trade changed the basis of its index number.

[3] Discontinued from January, 1921.

than in France or Italy. A fall in wholesale prices commenced in the United States (*Bradstreet*) in February, 1920, in the United Kingdom (*Economist*) and Japan in April, and in France and Italy in May. Other features to be observed from the table are the fairly close correspondence between the percentages representing the index numbers of *The Economist* and *The Statist* respectively, and the correspondence between the percentages representing the official index number of Canada with those representing the Bureau of Labour's index number for the United States. It is interesting also to note that wholesale prices in Sweden, which remained neutral throughout the war, have increased since 1914 more than in the United Kingdom. Owing to the different bases on which the various index numbers are constructed, all roughly weighted by including two or more varieties of certain commodities, some more weighted than others, the percentages shown in the tables cannot be taken as strictly representative of the relative rise in wholesale prices in the different countries.

COST OF LIVING. As has been already indicated, neither the index number of *The Statist* nor that of *The Economist* can be taken as accurately representing changes in the cost of living from time to time, for they are both based on wholesale prices, and neither takes into consideration the elements of rent, rates, and certain other items which must necessarily be included in an index number intended to represent variations in the cost of living. An attempt to construct such an index number, to represent changes in the cost of living for the working classes, based on retail prices, rent, etc., is made monthly by the Ministry of Labour, and the result is published in the *Labour Gazette*, from which the table given on the next page has been extracted.

In explanatory notes, the *Labour Gazette* states that the shown percentages are based on the average increases in the cost of the various items combined in accordance with their relative importance in pre-war working-class family expenditure. The result of this calculation (in which the same quantities and, as far as possible, the same qualities of each item are taken for each month as in July, 1914) is to show the ***increase in the cost of maintaining unchanged the average pre-war standard of living of the working-classes*** (i.e. the average standard actually prevailing in working-class families before the war, irrespective of whether such standard was adequate

or not). The *Labour Gazette* also points out that, owing to the shortage in the supplies of certain articles (e.g. butter), and the variations in the amounts of increase in the prices of different commodities, it is probable that economies or re-adjustments in expenditure have been effected in many families, especially in those cases where incomes have not increased so much as prices. No allowance is made in the figures for such economies and re-adjustments of expenditure, as to which trustworthy statistics are not available.

AVERAGE PERCENTAGE INCREASE IN COST OF LIVING SINCE 1ST JULY, 1914

(FOOD, CLOTHING, FUEL, LIGHT, RENT, ETC.)

Month (beginning of).	1915.	1916.	1917.	1918.	1919.	1920.	1921.
January . . .	10–15	35	65	85–90	120	125	165
February . .	15	35	65–70	90	120	130	151
March . . .	15–20	35–40	70	90	115	130	141
April	15–20	35–40	70–75	90–95	110	132	133
May	20	40–45	75	95–100	105	141	128
June . . .	25	45	75–80	100	105	150	119
July	25	45–50	80	100–105	105–110	152	119
August . . .	25	45–50	80	110	115	155	—
September . .	25	50	80–85	110	115	161	—
October . . .	30	50–55	75–80	115–120	120	164	—
November . .	30–35	60	85	120–125	125	176	—
December . .	35	65	85	120	125	169	—

It will be observed from the above table of percentages that the working-class cost of living, according to the *Labour Gazette*, increased by almost a constant yearly percentage during the first four years of the war. At 1st July, 1915, the increase was estimated at 25 per cent. above the cost of living at 1st July, 1914; at 1st July, 1916, at 45–50 per cent.; at 1st July, 1917, at 80 per cent.; at 1st July, 1918, at 100–105 per cent. During the next twelve months (which embraced the Armistice period commencing 11th November) the cost of living only rose slightly, to 105–110 per cent. above that at 1st July, 1914. But this small increase was followed by a rapid rise during the next year ending 1st July, 1920,

the cost of living at that date being 152 per cent. in excess of that six years previously, at 1st July, 1914. For the whole period of six years, the increase therefore averaged 25 per cent. per annum. A reference to the table of index numbers of *The Statist* and *The Economist,* already given, shows that wholesale prices rose more rapidly during the war and up to April, 1920, than the increased cost of living percentages compiled by the Ministry of Labour. The following table shows this divergence at the end of October, 1918; at the end of June, 1919; and at the end of March, 1920—

PERCENTAGE INCREASES.
(ABOVE INDEX NUMBER AT END OF JUNE, 1914.)

	At 31st Oct., 1918.[2]	At 30th June, 1919.[3]	At 31st Mar, 1920.	At 31st Mar. 1921.
The Statist Index Number	144	145	222	118
The Economist Index Number.	144	143	228	100
Labour Gazette, Cost of Living[1]	120-125	105-110	132	133

The percentages given in the last column (for 31st March, 1921) show that, during the reaction, wholesale prices have fallen far more rapidly than the cost of living.

Comparing prices with those ruling at the end of June, 1914, the index number of *The Economist* reached its maximum point, 228 per cent. increase, at the end of March, 1920, that of *The Statist* its maximum point, also 228 per cent. increase, at the end of the following month; and the percentage representing the increase in the cost of living, calculated by the Ministry of Labour, reached its maximum, 176 per cent., at the commencement of November, 1920.

Agreement between the percentage increases in the index numbers prepared by *The Statist* and *The Economist* and the cost of living percentage increases derived by the Ministry of Labour was not to be expected, because, as already stated, the former are based on wholesale prices and the latter on retail prices, rent, and other items entering into the cost of living. Rent has not moved with commodity prices. As a result of the Increase of Rent and Mortgage

[1] Percentage based on prices on first day of following month.
[2] Armistice with Germany, 11th November, 1918.
[3] Peace signed with Germany, 28th June, 1919.

Interest (War Restrictions) Act, 1915, rents of working-class dwellings remained at the same level as immediately before the war, apart from increases on account of increased rates and water charges—in other words, net rents of working-class dwellings remained unchanged generally from the end of 1915 up to the entry into operation of the Increase of Rent and Mortgage Interest (Restrictions) Act, 1920, which received the Royal Assent on 2nd July, 1920.

It usually takes a period of several months for changes in wholesale prices to reflect themselves fully in retail prices, unless the article is of a more or less perishable nature, when sympathetic movements take place almost concurrently.

The following table shows the average percentage increase, as compared with July, 1914, in retail prices of clothing (of the kinds most generally purchased by the working classes), at intervals of three months since the beginning of March, 1915, from which it will be observed that the increase by June, 1920, amounted to 320–330 per cent. above pre-war prices—

RETAIL PRICES OF CLOTHING, 1914-1921[1]

Year.	Percentage increase, as compared with July, 1914, at the beginning of			
	March.	June.	September.	December.
	%	%	%	%
1915	12½	25	30	35
1916	45	55	65	80
1917	90	100	120	140
1918	170	210	240	260
1919	260	260	260	270
1920	310	320–330	330	300–310
1921	240	200	—	—

The articles covered by the above shown average percentages are men's suits and overcoats, woollen materials for women's outer garments, woollen underclothing and hosiery, cotton material for women's outer garments, cotton underclothing material and hosiery, and boots.

In view of the great rise in wholesale prices of textile materials up to March, 1920, to which reference has already been made, the

[1] This table was published in the *Labour Gazette* for April, 1921.

great increase in retail prices of clothing up to September, 1920, is not surprising.

ECONOMIC REASONS FOR THE RISE IN PRICES SINCE JULY, 1914. It is impossible to examine in the space of one chapter all the many and varied economic influences that gave rise to the great increase in prices during and since the war, up to April, 1920, and the partial fall since that date. All that is attempted in this chapter is an enumeration, with a certain amount of explanation, of the more important of such influences operating in the case of the United Kingdom.

1. *Diversion of Labour from Productive to Non-productive Purposes.* Great wars have ever been a powerful factor in raising commodity prices, in the main due to the feeding, clothing, and transport of armies, and armament requirements necessitating greater production at a time when large numbers of men are withdrawn from the ranks of productive industry for fighting purposes and for performing services accessory to fighting. This change over from productive to non-productive industry was a prime cause of the reduction in available supplies of commodities for civilian consumption during the recent war. Intensified Government demand competed severely with civilian demand. A reduction in the customary quantities available for civilian consumption naturally causes a rise in prices, through increased competition for the reduced supplies. So strong is the desire to satisfy customary wants, that a reduction in supplies is usually accompanied by a considerably greater percentage increase in prices.

To what degree during the recent war there was reduction in production of commodities for the home market for civilian consumption, it is impossible to ascertain, for no accurate data is available. A reasonable estimate would be a reduction of from 25 to 33 per cent. A large part of the labour which was diverted from productive to non-productive purposes during the war was compensated for by increased hours of labour, relaxation of certain trade union rules which restricted production, and replacement by the employment of women and men previously unemployed or under-employed.

2. *Loans to Allies and Dominions.* Before the war the United Kingdom was increasing her investments abroad at the rate of about £200,000,000 per annum, which amount, however, about

represented interest on her foreign and Colonial investments. During the five year period 1st August, 1914–1st August, 1919, the British Government made loans to her Allies and Dominions to the extent of about £1,800,000,000, or at the rate of about £360,000,000 per annum. This amount was mainly expended for war materials and other goods produced in the United Kingdom, America, and other countries, and shipped to the Allies. To the extent that the proceeds of the loans were expended for purchases within the United Kingdom, so must stocks of commodities available for home consumption have tended to be reduced. Scarcity of certain commodities on the home market through shipment of supplies to the Allies would, however, be partly compensated for by increased quantities of such commodities imported from America and other countries during the war. Off-setting the increased quantities received from abroad against the reduction in the production of commodities by the United Kingdom for home civilian consumption, the quantities of commodities available during the war on the home market for civilian consumption were, as a whole, probably only from 15 to 25 per cent. less than pre-war quantities.

3. *Increased Costs of Production.* The factors that caused an increase in the costs of production varied in degree in different trades. They may be broadly classified under the four heads: (*a*) Increased wages; (*b*) increased costs of materials; (*c*) increased overhead and maintenance charges (salaries of office staffs, rents, rates, repairs, renewals, etc.); (*d*) increased sundry charges (carriage, cartage, wrapping and packing materials, travelling, gas, electricity, coal, bank charges, advertising, postages, stationery, etc.). Increased wages and a wider margin of profit taken by producers and traders are really the underlying causes of the increases given under (*b*) and (*d*). Labour was in a position to demand material increases in wages during the war on account of the paramount necessity for immediate and increasing production on Governmental and civilian account, and also because the cost of living was rapidly increasing. Producers and traders were able to take a larger margin of profit on account of scarcity of supplies, part of the increased margin being taken to meet increased taxation and increased cost of living. Speculators also took their opportunity.

4. *Shorter Hours of Labour.* Since the war terminated there has been a reduction in several trades in the number of hours worked

each week as compared with the number in pre-war times. This change was sanctioned by the Government and agreed to by the employers on the understanding that the reduction in hours would be compensated for by proportionate increased production during the reduced number of working hours. Unfortunately, labour has not in all trades, or in individual cases, responded to the compact. In some trades, the output per man, per hour, has actually been less since the termination of the war than in pre-war times. To some extent this reduced output is indirectly due to the considerably higher wages now paid to labour. In the case of a large number of workpeople, high wages have been accompanied by a disinclination to exert their best efforts. This vicious economic policy has been partly due to ignorance, partly to suspicion of exploitation by employers, and partly to disinclination for work at all times by many people if they can get others to work for them or to share with them the fruits of their industry.

The only economic justification for reduction in hours of labour at any time is increased output per man, per hour, whether the increase be due to greater efforts by labour itself, or greater application of machinery and other aids to output. And, notwithstanding promises of politicians, it is impossible for labour to enjoy a higher standard of living until there be an increased output, per man, per day.

5. *Multiplying Effect of Percentage Gross Profits.* In many trades, particularly in the retail trades, it is customary to fix the sale price of commodities at the ascertained costs of production, or the purchase price if the article be in a finished state ready for the consumer, plus a fixed percentage. The multiplying effect of percentage gross profits increases prices to the consumer by an amount much greater than increase in original costs, as the following example shows, the percentages being imaginary—

	MANUFACTURER.	MERCHANT.	RETAIL TRADE.
	Cost + 25%	Cost + 20%	Cost + 33⅓%
Article	8s. + 2s. = 10s.	10s. + 2s. = 12s.	12s. + 4s. = 16s
Same Article . .	16s. + 4s. = 20s.	20s. + 4s. = 24s.	24s. + 8s. = 32s.

The above imaginary illustration shows that though the manufacturer's costs to produce the article in question have only increased

8s., yet the ultimate consumer is asked to pay an increase of 16s. for the same article. Part of the difference will, of course, be absorbed in increased establishment charges of the merchant and retailer.

From the illustration there can obviously be drawn the following important truth : " The less the costs of production the greater the *real* wages of labour, for labour is the greatest consumer in any community."

6. *Psychological Influences.* Under the heading of psychological influences there may be included those human tendencies or weaknesses that contributed to the rise of prices. When prices are rising and manufacturers and salesmen predict a further rise in the near future, and these opinions are quoted in the Press, there is a tendency for people to purchase immediately articles they do not require at the moment but will require at some future date. This tendency is a species of hoarding and accelerates a further rise, and the trader then informs the public : " I told you so." This psychological influence also strongly manifested itself in manufacturers and traders alike. They competed strongly with one another for available supplies of materials and finished goods because prices were rising, and if the rise continued their trading profits would, as a consequence, be considerably augmented by early purchases of raw materials and stocks. This influence became very pronounced during the twelve months ending March, 1920, from which month it was checked by the consumer showing an increasing disinclination to purchase clothing and other articles at prices then current.

Another human weakness that contributed to the rise in prices during and after the war was a practical manifestation of the world-proved maxim " Easy come, easy go." During the war large wages were paid to munition workers, and on demobilization bonuses were paid to officers and men. Large numbers of those who became possessed of wages more than sufficient to maintain their customary standard of living, notwithstanding higher prices, and of those who obtained bonuses, proceeded at once to spend their surplus purchasing power on any thing or pleasure that took their fancy, almost regardless of utility value to themselves. A third psychological manifestation, and one that, for various reasons, largely proved a miscalculation, was a belief among

manufacturers, producers, and traders that, after the war, there would be a great world-wide demand for finished goods. Consequently, five or six months after the Armistice onwards, there arose a very keen and increasing demand for raw materials by manufacturers and for finished goods by traders in anticipation of a demand later to come from consumers in all countries, which only partly materialized. To some extent depreciated exchanges and heavy taxation restricted the anticipated international demand.

It is to be noted that psychological influences exert their maximum effect in accelerating a rise in prices during periods of excessive and increasing monetary inflation, a subject considered at length in a later chapter. In truth, such influences in their effect on prices anticipate, or discount in advance so to speak, further monetary inflation, and hence they are a potential danger when further inflation eventually is checked.

7. *Increased Taxation.* In whatever form increased taxation be imposed, whether direct or indirect, past experience has usually proved that the major part is ultimately passed on to the consumer. In assessing the margin of net profit he must derive from sales of his products or stocks, the manufacturer, producer, trader, or shopkeeper naturally bears in mind how much of such margin must eventually have to be paid to the State in the form of taxation. If taxation be increased, the margin of net profit will therefore usually be increased also, though not necessarily by the amount of the increased taxation. Since the commencement of the recent war taxation has increased enormously, and in many directions. Government revenue for the pre-war fiscal year ending 31th March, 1914, amounted to about £198,000,000, but for the year ending 31st March, 1920, to about £1,340,000,000,[1] an increase of £1,142,000,000, or 577 per cent., in six years. A large part of the increased taxation took the form of the Excess Profits Duty (receipts therefrom, year ending 31st March, 1920, £290,000,000), which in the main was passed on to the consumer by the manufacturer, producer, trader, and shopkeeper. The Excess Profits Duty was, therefore, an indirect form of taxation of the masses. The only people who cannot pass on increased taxation to other people are those in receipt of fixed incomes, derived from such sources as fixed salaries,

[1] Includes about £265,000,000 received from sales of surplus war stores, etc.

rent, and fixed rates of interest. Such people suffer most when the increased taxation takes the form of an increase in the Income Tax rates.

8. *Delays in Delivery.* Consequent on the great call on the man power of the country for fighting purposes and for performing services accessory to fighting, and for other reasons, there was during, and for some time after the war, considerable congestion at the docks, at the railway sheds, and in transport generally. Munitions of war, foodstuffs, and other articles required for the fighting forces had naturally priority in transit over commodities required for civilian consumption. Restricted postal facilities and various Government restrictions also impeded the movement of merchandise. Any cause which restricts the customary rate of movement of commodities, or alters or impedes the usual channels of flow of international commerce, is bound to be reflected in a tendency to higher prices.

9. *Shortage of Ships.* During the war a large part of the mercantile tonnage of the United Kingdom was necessarily employed in transferring troops, munitions, clothing, and foodstuffs to the various theatres of war. The destruction of a large amount of Allied shipping by German submarines also reduced the tonnage available for imports of commodities for civilian consumption. Delays caused by the necessary adoption of the convoy system, deviation of ships to unusual ports, and delays at ports owing to shortage of labour and other causes, are equivalent to a temporary loss of a certain amount of shipping. The shortage of tonnage and the great demand for the available tonnage enabled shipowners to increase freightage considerably more than increased working costs.

10. *Rise in Prices of Imports.* Before the war, about 70 per cent. of articles imported into the United Kingdom were foodstuffs and raw materials. During the war, Great Britain and other countries had to pay continually increasing prices for essential imports, for the effect of a great war, under modern conditions of international trading, is to raise the prices of commodities almost throughout the world, be the countries belligerent or neutral.

11. *Increased Freight and Insurance Rates.* During the war there took place a very great increase in freights, partly due to increased cost of running ships, reduction in speed owing to the convoy system being instituted as a protective measure against

enemy submarines, deviation to unusual ports, and considerably greater margins of profit taken by shipowners.

Marine insurance rates were increased on account of greater risks due to floating mines, enemy submarines, and other dangers at sea due to enemy action.

The great increase in freight and marine insurance rates was naturally passed on to the consumer in the prices demanded for important commodities.

There was a shortage of shipping tonnage owing to the immense amount of trooping and transport work in connection with the Allied armies, hence freights rapidly rose. Neutral shipowners benefited even more than British owners.

12. *Adverse Exchange Rates.* During the war, and since its termination, several of the foreign exchanges moved adversely to the United Kingdom on account of excessive balance of values of imports. This was only to be expected in view of the increased imports and decreased exports, in values, during the war, the consequence of great Governmental demands for war purposes. The movements would have been much more adverse to this country if the Government had not stabilized some of the exchanges by selling or pledging abroad large amounts of the foreign and Colonial securities held by the public and certain institutions of this country. When the value of sterling, as expressed by the exchange rate, falls in any country from which Great Britain makes large purchases, settlement for such imports is more costly than when the exchange rate is normal. So far as the United Kingdom is concerned, the New York Exchange is the most important, for from America this country imports large quantities of raw materials and foodstuffs. During 1920, sterling in New York stood at an average discount of about 25 per cent., that is to say, an importer in this country of goods from America would have to pay in sterling in this country to provide a certain amount of dollars in America, for settlement of his purchases, an amount equal to 33 per cent. more than he would have had to pay for the same amount of dollars before the war. (Before the war, £100 would provide, on an average, $486\frac{2}{3}$ dollars in America (parity, £1 = $\$4{\cdot}86\frac{2}{3}$). During 1920, £100 would purchase, on an average, only about 365 dollars in America.) The importer naturally passes increased costs for dollars on to the consumer. The latter receives

some indirect compensation when sterling is at a heavy discount owing to the fact that under such a condition the price in dollars the exporter has to accept to effect a sale is less than the price he would be able to command if sterling were at parity. To study this factor at length would involve a long explanation of the effect of depreciated currencies on import and export values under conditions which vary with different countries.

13. *Removal of Government Control.* After the termination of the war, maximum prices previously imposed by the Government on a number of commodities, with the object of preventing the exploitation of the community under scarcity conditions, were removed at various dates. Such decontrol taking place during a period when conditions were still abnormal, traders in such commodities, after the removal of maximum prices, were able to obtain excessive profits at the expense of the consumer. The great competition, however, between traders for available stocks, with a view of extracting large profits from the consumer, eventually led to their being caught with high-priced articles (raw materials and finished goods) when the inevitable reaction in prices eventuated.

Though there have been many economic and other influences in operation since August, 1914, as a consequence of the war, all tending to bring about a higher average level of commodity prices, yet there have been several, though of considerably less strength, tending to operate in the opposite direction. One such influence beneficial to the United Kingdom and her Allies was the deviation thereto during the war of a large part of the foodstuffs and raw materials which in peace time would have been purchased and imported by Germany.

If the war had not taken place, there is every reason to believe that there would have been a fall in commodity prices since 1914. An influence of great importance, and likely to be of long duration, had commenced to operate to reduce commodity prices about a year before the commencement of the war. This influence was suspended or largely nullified by the effects of hostilities. The influence referred to is that owing to the enormous amounts of capital attracted during 1907–1913, in particular from the United Kingdom, to food and raw material producing countries, there would necessarily follow, under conditions of peace, a considerable

increase, for many years to come, in the world's production of foodstuffs and raw materials. Consequently, a fall in commodity prices appeared to be inevitable, sooner or later. Index numbers show that during the period 1875–1896 there was a great and almost continuous fall in commodity prices, Sauerbeck's index number for 1896 being 61 as against 102 for 1874, or 102 the average for 1865–1874, the fall being mainly due to the rapid development during the seventies and eighties of the young food and raw material producing countries. From 1897 to 1913, with the exception of two breaks, there was a considerable rise in commodity prices, the index number for 1913 being 85 as against 61 for 1896. This natural rise in commodity prices once more attracted enormous sums of capital to the food and raw material producing countries. From the United Kingdom alone over £1,000,000,000 was attracted into foreign and Colonial investments during 1907-1913, a period of but seven years, one-half of which capital was devoted to productive railway construction. That this newly invested capital was not able to make itself fully felt in increased production during the war is obvious, on account of scarcity of labour in many countries. In the case of the British Colonies, a scarcity of labour was felt during the war owing to the large number of Colonials who patriotically volunteered to fight for the honour of the British Empire, many of whom paid the supreme sacrifice.

Prices during the recent war would undoubtedly have been much greater than the unprecedented heights they did actually reach, except for the fixing of maximum prices by the Government for essential foodstuffs and other necessaries, and Government purchases abroad on a wholesale scale.

CHECKS TO RISING PRICES. The main check to people competing by showing willingness to pay higher prices to satisfy their customary wants and desires is obviously the amount of money they have immediately available or will have available in the near future. This matter is considered at length in the next chapter. Another check to rising prices, and a very effective one, comes into operation when prices rise to such a degree that large numbers of the community prefer to abstain from satisfying all their customary wants and desires sooner than pay the demanded prices, and particularly so should there be evidence of profiteering or speculation. This second check became very effective from the

spring onwards of the year 1920. And a third check, and one that accelerates a fall, if economic conditions warrant a fall, is that consumers restrict or defer their purchases when there is a general feeling or evidence that prices will shortly be on the downward grade.

ECONOMIC REASONS FOR THE FALL IN PRICES SINCE APRIL, 1920. Since the end of March, 1920, as already stated, and up to the end of May, 1921 (the time of writing), there has taken place a very substantial fall in wholesale prices, the index number of *The Economist* showing a fall of 41 per cent., and that of *The Statist* one of 38 per cent. Different groups of commodities have shown falls of varying degree, the greatest having taken place in the textile group, the index number for which has fallen 66 per cent., according to *The Economist.* Generally speaking, the economic reasons for the fall in prices since April, 1920, may be said to be a reversal or removal, in part, of the operating causes for the rise that took place between July, 1914, and March, 1920. Certain new and unexpected factors have also contributed to the fall. Both sets of influences are briefly discussed below.

1. *Diversion of Labour from Non-productive to Productive Purposes.* The demobilization of the greater part of the Army, and the release of workers from armament requirements, has enabled considerably increased numbers to be employed to produce commodities for home and foreign civilian consumption.

2. *Cessation of Loans to Allies and Dominions.* The cessation of further British Government loans to her Allies and Dominions has enabled the home market to have a greater quantity of commodities available for home consumption, for such loans made during the war lifted large quantities of commodities off the home market for exportation to the Continent.

3. *Reduced Costs of Production.* It is not possible to say with certainty that costs of production have as yet, as a whole, been materially reduced. In certain trades they undoubtedly have. Wages in some trades have remained stationary since April, 1920, in others they have been further increased, but in several trades reductions in wages have already taken place, in some cases representing part or the whole of further advances made since April, 1920. The cost of raw materials has, generally speaking, fallen considerably —particularly in the textile trades. Overhead and maintenance charges, and sundry charges have, as a whole, not shown any

material change. Some of the charges have gone down, a few have increased, such as local rates and railway charges.

4. *Hours of Labour.* No material change (except short time necessitated by over-stocked markets and lack of foreign orders). Increase in unemployment.

5. *Multiplying Effect of Percentage Gross Profits.* When costs of production fall, the consumer obtains a reduction in price greater than the reduction in first costs. For reason of this divergence see "Economic Reasons for the Rise in Prices," paragraph 5.

6. *Psychological Influences.* Prices reached such a height during the first three months of 1920 that consumers commenced to restrict their purchases, and by their joint action compelled the beginning of a fall. In times of falling prices, consumers defer their purchases as long as possible, in view of a further reduction in the near future. Manufacturers, producers, and traders commenced restricting their purchases of raw materials and finished goods because they found themselves over-stocked, and any further purchases in a falling market might involve them in serious losses unless they were able to sell forward before purchasing.

7. *Taxation.* Since March, 1920, taxation has been slightly increased, so this factor would tend to retard a little the fall in prices.

8. *Quicker Delivery.* Since the end of 1919 there has been more prompt conveyance of goods, consequent on a greater amount of labour being available for transport purposes, and increased rolling stock for conveyance of goods for civilian consumption.

9. *Increased Mercantile Tonnage.* Since Peace was signed with Germany and the greater part of the Army abroad brought back to this country and demobilized, there has been considerably increased mercantile tonnage available for transport of commodities. Ships can now move at their customary speed, and load and unload at suitable ports convenient to themselves. A large amount of new tonnage has also been launched since the termination of the war.

10. *Reduction in Prices of Imports.* There have taken place considerable reductions in the prices of foodstuffs, raw materials, and other articles imported from abroad. The reductions commenced in the United States about April, 1920. Many imported raw materials, such as cotton and wool, have fallen in price 60–80

per cent. since March, 1920. Certain foodstuffs, particularly wheat, did not show a material fall in price in this country during 1920 on account of being under Government control. A reduction in the import price of wheat, however, enabled the Government to remove its subsidy on bread early in 1921.

The fall in prices of raw materials has been relatively much greater than that of finished goods, because manufacturers have deemed it advisable to reduce production as far as possible to current demand, and not to make goods for stock purposes. Obviously, with very high conversion costs, of which there is every prospect of a material reduction in the near future, a manufacturer making for stock runs a grave risk of eventually being undercut in price by lower quotations of a competitive manufacturer working on a lower conversion cost basis at a later date, at the time of revival of a general demand ; in other words, manufacturers naturally hesitate to " marry " deflated raw material to non-deflated conversion costs. There has, consequently, already taken place a more rapid decline in prices of raw materials than in finished goods, in fact, to such an extent that certain qualities of wool by April, 1921, had fallen to pre-war prices.

11. *Reduced Freights and Insurance Rates.* Early in 1920, shipping lines began to make a reduction in freight rates, a movement which became very pronounced during the latter months of the year and early months of 1921. Following the signing of Peace with Germany, there took place a considerable reduction in marine insurance rates.

The enormous reduction that has taken place in freight rates since the highest point was reached early in 1920 is clearly shown by the following two examples—

RIVER PLATE TO UNITED KINGDOM

1920 (highest rate)	210 shillings per ton
[1]1921 (highest rate)	30 ,, ,,
1913 (highest rate)	30 ,, ,,

CARDIFF TO ST. VINCENT

1920 (highest rate)	50 shillings per ton
[1]1921 (highest rate)	14 ,, ,,
1913 (highest rate)	12 ,, ,,

[1] Up to April.

Obviously the very severe fall in freight rates cannot be maintained in face of present running costs of ships in overseas trade, which, in April, 1921, were estimated to be from 250 to 300 per cent. above the cost in 1913. The excessive fall in freight rates has, in the main, been due to increase in the world's available tonnage since 1919 and insufficiency of cargo offering, owing to great depression in foreign trade. In April, 1921, for lack of cargo at remunerative rates, over one-half of the overseas and coastwise tonnage of the United Kingdom was laid up in idleness in the ports of the country.

12. *Exchange Rates.* Since the termination of the war with Germany, the foreign exchanges, as a whole, have become more favourable to the United Kingdom, though in a few countries sterling has remained at a discount, in particular in New York. This important exchange, however, at the time of writing (May, 1921) is showing a steady improvement. The improvement in the exchanges as a whole to the United Kingdom has been due to a reduction in the money value of the excess of imports over exports. Taking invisible exports into account, there has been since the end of 1919 an actual net balance in favour of the United Kingdom.

13. *Cancellation of Orders.* One of the main causes that accelerated the fall in prices since April, 1920, was the cancellation by foreign buyers of orders already placed with the United Kingdom for high-priced goods, in particular textiles. Cancellations were also received from the Colonies. Many of the cancellations received related to goods already shipped but not taken up by the consignees. Three causes contributed to this lapse of commercial morality. First, over-stocked markets abroad, a condition aggravated by consumers restricting their purchases sooner than pay the prices demanded for goods, the inability of Germany to find means of payment for large quantities of high-priced imports, and the chaotic condition of Russia. Second, increasing evidence of a coming permanent fall in prices, a condition which naturally makes retailers and all traders loath to stock or increase stocks of high-priced goods, because competition of other traders with lower-priced goods would involve them, sooner or later, in serious losses, when the necessity arose to cut prices to meet such competition. Third, financial pressure. Unless a firm be in an exceptionally strong position in regard to its liquid resources, cancellations

received by it on a large scale cause extreme financial embarrassment, in some cases involving forced realizations of stocks at prices much less than cost.

Cancellations within the home market have been largely the result of cancellations received from abroad. Merchants and traders have begged manufacturers to cancel orders previously placed with them, in some cases offering part compensation, on account of cancellations received from abroad. Manufacturers in their turn have attempted to cancel orders they had previously placed for raw materials. And so the chain of cancellations has tended to grow. The net effect of the cancellations has been a willingness to accept lower prices all round ; in many cases prices less than the former cost of production. Pressure by banks for part reduction of outstanding loans accelerated forced realizations.

14. *Reduced Margins of Profit.* Over-stocked markets, whether the primary cause of such conditions be over-production, cancellation of orders, or any other factor, make retailers, merchants, manufacturers, and raw material producers willing to accept a very small margin of profit to effect sales of their wares ; in some cases they are willing to sell on a no-profit basis. The consumer is largely the controller of prices, for a while, under such conditions. Since about April, 1920, the increasing willingness of traders to reduce margins of profit has had a very considerable influence in accelerating the fall in prices since that date. Many manufacturers, in times of depression, prefer to run their mills at a loss sooner than disperse their workpeople, relying on profits in times of activity to recoup them for such loss.

15. *Unemployment or Short-Time Working.* Periods of rapidly falling prices are invariably accompanied by a growing volume of unemployment, for, as already explained under the heading " Psychological Influences," the general public, retailers, merchant houses, and manufacturers all defer, as long as possible, further purchases of finished goods or raw materials, with the object of purchasing at a later date at lesser prices and minimizing the risk of business losses. Widespread unemployment obviously reduces the purchasing power of the working classes, and consequently accelerates the fall in prices.

CHAPTER XI

COMMODITY PRICES—MONETARY INFLUENCES

THE use of the term "monetary influences" in this chapter will be confined to the amount of purchasing power available at any time and its velocity of circulation. The term "goods," repeatedly made use of, is intended to include not only commodities but all services, securities, property, and anything else for which, in exchange, purchasing power is transferred to the seller.

At the commencement of the last chapter it was pointed out that in any analysis of the factors that cause variation in prices of commodities at any time, two sets of variable influences have necessarily to be considered: the first, *Economic*, the second, *Monetary*; in other words, the available supplies of goods for sale and the available purchasing power of the community. These two sets of forces are ever in conflict, and their relative strength finally determines the course of prices. Economic influences operate through variation in available supplies of goods; monetary influences operate through variation in ability and willingness to purchase. When the two sets of forces are temporarily in equilibrium, supply is then said to meet demand. The economic influences that contributed to the great increase of commodity prices during August, 1914–March, 1920, and the partial fall since the latter date, having been considered at length in the previous chapter, monetary influences will be mainly considered in the present chapter. An attempt will also be made to determine to what degree monetary influences contributed to the great rise in prices during the above-named period.

Some readers may consider the economic influences enumerated in the last chapter sufficient in themselves to account for price variations since the commencement of the recent war. A little reflection should show, however, that the ultimate degree to which prices may rise as the result of changed economic conditions must obviously be mainly dependent on the amount of additional

purchasing power available. Without considerably increased purchasing power having been manufactured by the banks and the Government during the war, it is obvious that a large percentage of consumers would have had materially to reduce their purchases of commodities or hire of labour, for want of immediate means of payment, and this applies equally to raw material producers, manufacturers, merchants, retailers, and the final consumers. Assuming the amount of purchasing power to have remained stationary during the recent war, there must have inevitably taken place a gradually diminishing consumption of commodities as economic influences tended continuously to increase prices. A point would eventually have been reached when supply met demand, and a check administered to any further rise in prices. Economic conditions alone could probably not have caused the average level of general prices to have risen during the period August, 1914–March, 1920, more than 75 per cent. over the pre-war level, for reasons stated later. If purchasing power be continuously manufactured by the banks and the Government at a rate materially greater than any increase in available supplies of commodities, there is practically no limit to the height prices may be forced, to be accompanied or followed, sooner or later, by all the evils resulting from a policy of inflation.

Diverse Opinions. Not only during the recent war, but as far back as economics first came to be studied as a science, there have always been three schools of thought as to the influences that may cause variation in the general level of prices at any time. One school maintains that prices are controlled by economic conditions ; another that prices are correlative to monetary conditions ; and the third that prices are governed by economic and monetary conditions combined. As will be shown later, only the third school of opinion can be supported after an examination of the various influences that ultimately determine the level of general prices. The conflict of opinion between the first two schools really narrows down to a determination of " cause " and " effect." Admittedly, it is not so easy for the mind at first to grasp the very close relationship beteeen monetary conditions and the average level of prices. It will therefore be advisable, before discussing the effect of monetary influences on prices during the war, in order to simplify the discussion, to consider briefly : (1) What constitutes

the available purchasing power of the community ; (2) the equation of exchange ; (3) the quantity theory of money ; and (4) the influence of variation in gold supplies on prices in pre-war times.

DIFFERENT FORMS OF PURCHASING POWER. The available purchasing power a modern community has at its immediate command is the quantity of money in the pockets, homes, and other receptacles of or belonging to the public, plus the amount of obligations of banks to pay legal tender on demand, plus commercial credit.

Money may be defined as that commodity or article (which may be slips of paper or other material impressed or marked thereon with a certain amount or number of units of purchasing power) which is universally accepted within a community in exchange for goods offered for sale or in discharge of debts. The general acceptance of the article offered as money may be due either to its legal tender character or to custom. Bank notes are included in this definition subject to their being legal tender or accepted by general consent throughout the community.

Bank credit balances, payable on demand in legal tender to the order of customers, and bank promises to customers to allow them to overdraw their accounts up to an agreed upon limit, are not included in the above definition of money. Such forms of purchasing power are, however, but one stage removed from money. In all cases where an order to a bank to pay legal tender on demand (a cheque) is willingly accepted in exchange for goods, or in discharge of debts, such order obviously exercises the function of money. In actual practice, the payee named on the cheque does not usually demand legal tender on presentation of the cheque, but simply requests collection and credit to his own bank account of the right conveyed by the cheque to demand legal tender for its face amount at any time on demand. Whilst it may be truly said that money is mainly used in payment of wages and for settlement of retail transactions, the clearing house figures of banks prove indisputably that the part transfer of bank credit balances, or of bank promises of credit, authorized by customers' cheques, is almost wholly the medium of settlement for all other exchanges or transactions transferring value. It may therefore be said that, generally speaking, the money of the mercantile community consists of demand orders on banks authorizing the payment of, or transfer of claims

to, legal tender. In some cases the orders drawn on banks are to pay legal tender at some determinable future date.

A third kind of purchasing power comes into operation when a retail shop, trader, manufacturer, or producer permits a customer to purchase goods without immediate payment. This is commercial credit, the aggregate amount of which varies considerably at different times. Sometimes, a bill of exchange, bearing a determinable future date of maturity, will be drawn by the seller of the goods on the purchaser, by whom the obligation will be accepted. An important point, however, to notice about purchasing power exercised through a person's commercial credit is that, sooner or later, such credit must be liquidated by the transfer to the seller of the goods, or to his order, of money or of acceptable rights to delivery of legal tender from a bank on demand.

There is still another form of purchasing power that may be exercised, which may best be described as a set-off of mutual indebtedness. If A supplies B with, say, £1,000 value of goods on credit, and B, a few days later, supplies A with £1,000 value of another class of goods, both A and B may obviously cancel their mutual indebtedness by book entries, and no money need pass between the parties to liquidate the two transactions. And yet the transactions cannot be described as barter.

There are other minor forms of possible purchasing power available, such as postal orders, but their aggregate amount and effect on prices is relatively very small compared to that of those above described.

By the term "velocity of circulation," as applied to money or available purchasing power, is meant the number of times the average amount of money or of purchasing power in circulation within a community during a chosen period is turned over during such period; in other words, the average rate of turnover. It is preferable to confine the use of the term entirely to such money or purchasing power as has effected at least one exchange for goods during the chosen period.

The Equation of Exchange. After the foregoing remarks on the nature of money, the available forms of purchasing power, and the meaning of the expression "velocity of circulation," the equation of exchange may be considered. This equation may be defined as a statement, in mathematical form, of the total exchange

transactions effected in a certain period in a given community. It is shown below in algebraical characters—

$$M V = \Sigma p Q \text{ or } P T$$

where M = average amount of purchasing power in possession of a community, every unit of which has effected at least one exchange for goods, during a given period, say, a year.

V = velocity of circulation of such purchasing power (number of times M is turned over during the year).

ΣpQ = the summation of a series of terms of the form pQ, where p = price and Q = quantity. (The sum total, in money, of all individual purchases during the year.)

P = an accurately constructed and weighted index number, representing average prices paid for goods during the year.

T = total quantity of goods exchanged for purchasing power during the year.

As MV must obviously be equal to the total expenditure, it is evident that the Equation of Exchange is nothing more than a statement, in algebraical form, to the effect that the total expenditure of a nation during any period equals the sum total of all individual purchases, of whatever nature, during the same period, which is an obvious truth. The main utility, however, in expressing the total expenditure of a community in the form shown by the Equation of Exchange is that it brings out clearly to the eye the direct relationship between the average level of prices and the total amount of available purchasing power. If V and T remain constant, it is obvious that P must show proportional variation to variation in M. If V varies but M remains constant, it is also evident that P or T must vary, or both magnitudes. V generally increases when there is an outburst of extravagance, as there was during the recent war.

Some exponents of the Equation of Exchange do not insist that every unit of M shall have entered into at least one exchange during

the chosen period.[1] Some include in the equation the total volume of bank deposits *subject* to be drawn upon by cheque payable on demand. Obviously, if there be included dormant available purchasing power, to make the two sides of the Equation of Exchange balance, V will differ from V when the equation includes only purchasing power that has effected or entered into at least one exchange during the same period, and assuming P and T to remain constant. If the total amount of bank deposits subject to be drawn upon by cheque be included in the equation, it is advisable to include also the amount of bank deposits not subject to be drawn upon by cheque, and whether at call or at short notice. V will obviously vary according to the meaning given to M, and will also be somewhat affected by other influences.

The Equation of Exchange can also be expressed in a third form where M simply represents average amount of legal tender money in circulation and in possession of banks. This form of equation is true in a general sense, but bristles with difficulties of explanation and qualifications. It is known that banks try to maintain a fairly constant percentage cash reserve to their total deposit liabilities, that 90 per cent. or so of such liabilities are the result of various forms of previous advances by the banks, that advances by banks vary with the amount of their cash reserves, the volume of trade and prices, and that the amount of money in active circulation varies with the average level of retail prices and the standard of living. The amount of money in circulation therefore indirectly roughly reflects the amount held by banks in the form of till money and reserves. The proportion between the two, however, is ever subject to variation by the extent to which settlement for retail transactions is effected by cheques, and any alteration in the customary percentage basis for cash reserves of banks.

The so-called quantity theory of money, that prices vary proportionately to the amount of available purchasing power, if the

[1] Professor Irving Fisher, who, in his book *The Purchasing Power of Money*, deals very fully with the Equation of Exchange, expresses it in the form

$$MV + M^1V^1 = \Sigma\, p\, Q \text{ or } PT$$

where M represents the average amount of money in circulation and M^1 the average amount of bank deposits *subject* to cheque. It is preferable, however, to give the Equation in the form already shown above, where M represents the average amount of purchasing power in possession of a community, every unit of which has effected at least one exchange for goods, during a given period.

velocity of circulation and the volume of trade remain constant, has been bitterly attacked in the past by certain writers. As already shown, the truth of this theory is proved beyond any doubt by the Equation of Exchange. What the theory does not state, and which the opponents of it find convenient to forget, is that prices vary proportionately to the amount of available purchasing power *regardless* of change in economic conditions, in the habits of the people, in population, or in other conditions. No supporter of the quantity theory affirms that if the amount of available purchasing power between two dates has been doubled, the average price level must necessarily have doubled also. An increasing amount of available purchasing power, from whatever source derived, usually comes into circulation slowly, and in the course of becoming part of the active circulation gives rise to alteration in the total volume of trade and other economic disturbances. It stimulates demand until finally absorbed by a higher level of prices, and will also cause, in any case for a period, an alteration in the usual distribution of purchasing power previous to the increase. When the time arrives when further increase in available purchasing power is stopped, the volume of trade will *tend* to resume its normal level, subject to no alteration in other conditions. The velocity of circulation at such time will also tend to become normal again, because this rate is largely determined by the fixed habits of the people. During the period of increasing purchasing power, the velocity of circulation would slightly increase, on account of trade activity. It can therefore be asserted that average price levels in two normal periods (neither of which is a transition period) will roughly be proportionate to the average amount of purchasing power in circulation during such periods, assuming no material change to take place in the total population. There is very little likelihood, in practice, of the average price level varying in exact proportion to the amount of available purchasing power, for during the period of increasing purchasing power, and consequent trade activity, additional productive plant will have been erected. This and other factors are bound to leave some permanent alteration, however slight, in the economic conditions of the country, particularly in the output capacity. The greater the output the less will generally be the average price level of commodities, until the growth of population absorbs the increased production.

Effect of Variation in Gold Reserves. In pre-war times, the effect of a large inflow of gold into the United Kingdom during a period of depression or of normal trade was generally to cause an increase in trade activity, accompanied by a period of rising prices, unless the inflow of gold was the consequence of the imposition of a high Bank Rate necessitated by too great a depletion of bank gold reserves within the country. An alteration in the Bank Rate in pre-war times had usually a material effect on the foreign exchanges, particularly if no corresponding alteration was made in the chief foreign Bank Rates. By the operation of the Bank Rate, gold could be drawn from abroad or be dispelled abroad at the will of the Bank of England. Bank Rates, indirectly, were the instruments tending to level prices throughout the world, after making allowance for differences due to tariffs. Higher prices in the United Kingdom than abroad tended to cause an outward drain of gold; lower prices in the United Kingdom than abroad tended to cause an inflow of gold. Bank Rates operated eventually as effective checks on countries overtrading for any length of time.

When the Bank of England obtained more gold than it required to support its customary percentage cash reserve, it lowered its rate for discount. This reduction was immediately reflected in a reduction by the joint stock banks in loan rates to their customers, and was usually also accompanied by a greater willingness of the banks to increase the aggregate of their loans. Manufacturers and traders, being able to obtain credit at a lesser rate of interest, they proceeded to compete more severely for raw materials and finished goods, with the object of doing a greater trade and increasing their business profits. Wholesale prices tended to rise as a consequence, to be followed later by a rise in retail prices. The increased demand for labour naturally also caused wages to rise, but usually more slowly than the rise in wholesale prices. Finally, the increased gold reserves of the Bank of England (beyond any gold sent abroad) were absorbed by an increased amount being drawn into internal circulation in consequence of high wages and increased retail prices, and by the joint stock banks increasing their own reserves of gold to support the increased amount of their deposit liabilities, mainly the result of the expansion in bank credit. A trade boom once started, however, always oversteps the mark warranted by the

increased amount of gold within the country. Sooner or later there arises an excessive strain on credit, the Bank of England and the other banks find their metallic reserves falling below what they customarily consider a safe percentage of their deposit liabilities, and a rise in Bank Rate and in the rate of interest charged by other banks for loans becomes inevitable. The effect of the rise is to check further commercial development on account of high interest charges for loans of bank credit. A period of depression then usually follows on account of over-stocked markets in proportion to available purchasing power.

Should a trade boom commence in the United Kingdom as a consequence of receipt of large foreign orders, the first effects are higher wages and increased home demand as a result of the higher wages and of the increased demand for materials. A boom in one trade always invariably causes activity in several other trades. A strain is, however, soon felt on the Bank of England gold reserve on account of an additional amount of gold being required for internal circulation and through the joint stock banks endeavouring to maintain their customary percentage cash reserves. If the Bank of England obtains no additional gold from abroad, the Bank Rate has to be raised, and ultimately an effective check is given to the boom, to be followed by a period of depression. Though it may be said that an economic factor (foreign orders) started the boom, it is to be observed that the available quantity of reserve gold in the United Kingdom, and consequently of bank credit, finally determined the extent of the resultant trade activity.

From what has already been said, it is evident that two sets of influences ultimately determine the general level of prices—the first economic, the second monetary—the degree of influence exerted by the former being largely controlled by the intensity of the latter. Economic influences cannot, in themselves, cause a prolonged and material increase in prices, as was experienced during the recent war, unless accompanied by an increasing amount of available purchasing power, but an increased amount of available purchasing power can cause a higher average level of prices and also effect certain permanent alterations in economic conditions.

Willingness to Purchase, an Important Factor. Though it has been laid down that economic and monetary influences combined determine the course of prices, it has not so far been explained

why an increase in the amount of the available purchasing power of the public should, of itself, tend to raise commodity prices. The reason is as follows: An increase in the proportion between available purchasing power and the supply of available goods and services operates in raising prices through the almost universal desire to satisfy human wants, whether necessaries or not. Individuals with increased purchasing power tend to increase their purchases until their wants, appetites, or desires are satisfied, and, in consequence, to force up prices through competition for available supplies. Manufacturers, producers, and traders with increased purchasing power tend to compete more severely with one another (except in times of falling prices caused by changing economic conditions) for labour, materials, and finished commodities, with the object of increasing their business profits. A very simple illustration of prices being forced up by an expansion of bank credit can be given by imagining six wool merchants to attend the same wool sale, three of the merchants operating with their own capital of, say, £50,000 each, and the other three with bank credit running to, say, £250,000 each. It is obvious that if the wool is wanted for consumption the latter three will force up prices to a higher level than if they were restricted in purchasing power to £50,000 each. The spinner, the manufacturer, and the merchant next come along in their turns to their banks for increased accommodation with the plea that the increased price of wool, yarn, and cloth necessitates greater credit for them to carry on their business. Finally, the consumer asks for increased wages or salaries. It is easy to see that £100,000 of bank credit applied to the purchase of raw material may give rise to a further demand for bank credit of £50,000 or £100,000 before the finished article reaches the ultimate consumer. This is one of the evils of inflation of available purchasing power.

Not only a change in the aggregate amount of available purchasing power within a community, but also a change in the distribution of purchasing power, tends to cause variation in the intensity of demand, and therefore to affect the general level of prices, on account of individual variation in willingness and ability to purchase. The recent war, and the great additional amount of available purchasing power created during its continuance, and up to March, 1920, has caused an enormous change in the customary or pre-war distribution of the purchasing power of the community, part of

which change will be more or less permanent for a considerable number of years. People with fixed incomes or salaries have necessarily had to reduce their consumption of goods and services since the rise in prices.

From what has already been said it is obvious that three factors really enter into the price of any article. First, the available supplies for sale ; second, the available purchasing power ; and third, the willingness of the public to exchange purchasing power for the article at a rate of exchange determined by the owner of the article and the costs of production. As was pointed out in the previous chapter, willingness to purchase or spend is always a psychological influence of great weight in determining the general level of prices.

Monetary Inflation Since 1914

Monetary Inflation may be defined as "an increase in the aggregate of the elements constituting the immediate available purchasing power of a community not accompanied by a proportionate increase in the total supply of available goods and services continuously at the disposal of the community." The term "monetary inflation" (for short, inflation) has obviously a somewhat different meaning from that given to the magnitude M in the Equation of Exchange already discussed. It has been repeatedly used by the Press and various writers and speakers since 1915, when referring to the effect on prices of the great expansion in bank credit and in the Currency Note issue since that year. The meaning given to M in the Equation of Exchange was the average amount of available purchasing power in existence within a community during a certain period, every unit of which had entered into at least one exchange for goods during the period. There being no available data from which to calculate M or V (the velocity of circulation), either before or since the war, the effect of monetary influences on prices since 1914 will therefore be considered from the monetary inflation standpoint. To those readers who do not clearly grasp the significance of the Equation of Exchange, the effect of monetary influences on prices, considered in a general sense, will more clearly bring out the enormous influence exerted by the unprecedented amount of bank credit created since 1914 and the issue of Currency Notes.

The immediately available purchasing power a community possesses under modern conditions of credit is, as previously stated, the aggregate of its credit balances at its bankers, a relatively small amount of gold, silver, copper, and notes (whether issued by banks or the State) in the hands of the public, unused bank credit, and unused commercial credit. No approximate estimate can at any time be given of the last two items. Unused bank credit refers to outstanding bank promises of advances to customers not included in the amount of commercial bank deposits (balances standing to credit of customers). In London, a customer of a bank may arrange for a loan of a given amount to be credited to his account immediately or arrange a loan limit and instruct the bank, from time to time, to place specified amounts to his credit under the limit. In the provinces, banks do not credit their customers with promised advances, but agree to allow customers to overdraw up to certain specified limits. The London practice tends to increase the amount of credit balances (deposits) immediately on grant of loans, but the provincial practice only when promised loans are actually drawn upon by customers.

The expression " unused commercial credit " refers to the further amount of credit traders are prepared to afford to one another, or shopkeepers to their customers. This amount necessarily varies with the course of trade, prices, and atmosphere of confidence, and is not possible of even rough estimation.

Ignoring unused bank credit and unused commercial credit, the amount of available purchasing power in the hands of the public at 30th June, 1914, and at 31st December, 1919, is shown approximately by the table on the following page.

The currency amounts shown in the table include gold, silver, copper, and notes (whether issued by banks or the State) in the hands of the public, exclusive of currency held by the banks. They are the amounts quoted (as estimates) by the Chairman (the Right Hon. R. McKenna) of the London Joint City and Midland Bank at the Annual Meeting of Shareholders of that bank on 29th January, 1920.

Any estimate of the actual amount of currency in public circulation at any time must necessarily be rough, because, though the Mint before the war was able to state the amount of gold coins issued and the amount withdrawn each year, there are no means

of ascertaining the amount of gold coins melted and used for the arts and manufactures, or taken and left abroad by travellers or other people leaving this country. The amount of Bank of England notes in public circulation (exclusive of such notes in bank reserves) was also unknown, but could have been ascertained if the banks had published the total amount of such notes in their possession.

AVAILABLE PURCHASING POWER OF PUBLIC

(In Million £'s)

	At 30th June, 1914.	At 31st Dec., 1919.	Increase for $5\frac{1}{2}$ years.
Commercial Bank Deposits [1]	1,071 [3]	2,399	1,328 or 124%
Savings Bank Deposits [2] .	260	355	95 or 37%
Currency	128	393	265 or 207%
Total . .	1,459	3,147	1,688 or 116%

Bank of England deposits are not included in the above table because, in the main, such deposits consist of balances of bankers and of other financial institutions, the amount of which cannot be approximately estimated. Only a relatively small part of the deposits of the Bank of England may be said to represent available funds of the trading community.

The foregoing table shows that the available purchasing power of the public increased by, roughly, £1,688,000,000, or 116 per cent., during the period 1st July, 1914–31st December, 1919; Commercial Bank deposits increasing, roughly, £1,328,000,000, or 124 per cent.; Savings Bank deposits, £95,000,000, or 37 per cent.; and Currency (say) £265,000,000, or 207 per cent.

From the particulars that have been given, it is obvious that

[1] Aggregate amount of credit balances, whether on deposit or current account. Does not include sums deposited with branches of foreign banks in London, or with Head Offices of banks in London operating, in the main, in foreign or Colonial countries, or with discount houses. Such amounts are not ascertainable.

[2] Includes amount deposited in Supplementary Departments of Trustee Savings Banks.

[3] At 31st December, 1913, but the amount at 30th June, 1914, would not differ materially. The average annual increase in Commercial Bank Deposits during the ten years 1904–1913 was £30,000,000.

the great increase in the total available purchasing power of the community during the six years ending 31st December, 1919, was mainly due to increase in bank deposits. The abnormal increase in bank deposits during this period was mainly due to bank subscriptions to various forms of War Loans and to increased advances to customers, particularly from the date of the Armistice in the case of the latter.

During the six years ending 31st December, 1919, banks increased their investments by £389,000,000 ; their discounts to the Government, to traders, and other people, by £208,000,000 ; and their ordinary advances by £501,000,000, part of which latter amount represented advances to enable customers to subscribe to War Loans. No part of the net increase in commercial bank deposits since 1914 has been due to an excess deposit over withdrawal of legal tender by customers. On the contrary, there has taken place since that year an excess withdrawal of legal tender, consequent on the rise in wages and prices.

In other chapters of this book it is pointed out that when banks subscribe to War Loans they, in net effect, contract with the Government (in return for interest bearing securities) to credit the amount of their subscriptions to customers, to whom payments are due from the Government for goods and services supplied for the destructive purposes of war or for other purposes. The expansion of credit, through bank subscriptions to War Loans and other forms of Government borrowings, enabled the Government to lift large stocks of commodities from the market. After the Armistice, traders obtained considerably increased grants of credit from the banks on the plea that the higher prices of materials and finished goods necessitated larger amounts of credit to enable them to conduct their businesses. When traders obtain grants of credit from the banks, they, like the Government, are in a position to lift materials and finished goods off the market. It is important to note that an expansion in bank credit is not in itself an economic evil, for bank credit is absolutely essential to modern production. It is only when increased credit is not accompanied or followed in the near future by increased production (in quantity) that economic evils arise.

When customers of banks obtain credit from banks in order to subscribe to War Loans, no great inflation of commodity prices

will be caused by this action, provided such customers repay the borrowed credit at an early date by a transfer of credit from some other source. This transfer necessarily entails one or more other accounts with a credit balance being debited with the amount.

Subscriptions by members of the public to War Loans out of their own credit balances at the banks do not cause monetary inflation, because, taking the banks as one unit, after Government disbursements of such subscriptions, in net effect, debits and credits are created which cancel one another ; and therefore the aggregate of banking deposits (customers' credit balances) remains stationary, or diminishes if some of the return credits pass to accounts with debit balances.

The great expansion in bank credit during and since the war was facilitated by the great increase in bankers' balances at the Bank of England, due to various operations between the Government, the Bank of England, and the Joint Stock Banks, and the issue of Treasury Currency Notes, a full explanation of which is contained in the chapter devoted to the banking position during the war.

As has been previously pointed out, an increase in the proportion between the immediate available purchasing power and the supply of goods and services at the disposal of a community operates in raising prices through the almost universal desire to satisfy human wants, whether necessaries or not, or to increase business profits. Individuals with increased purchasing power tend to increase their purchases until their more urgent wants, appetites, or desires are satisfied, and, in consequence, to force up prices through competition for available supplies. Manufacturers, producers, and traders with increased purchasing power tend to compete more severely with one another for labour, materials, and finished commodities with the object of increasing their business profits. It is a self-evident truth that the degree to which any person or institution may compete for any article must ultimately be governed by the purchasing power resources of that person or institution.

It cannot be asserted, as already indicated, that commodity prices will necessarily rise proportionately to any increase in the ratio between the purchasing power and supply of goods at the disposal of a community. If the available supply of goods be

supposed not to vary from week to week, there is every reason to believe that, over successive equal periods of time, increases in purchasing power would not be accompanied by proportionate rises in the index number of commodity prices. Probably, a curve plotted with purchasing power as abscissae and the index number of commodity prices as ordinates would show an increasing falling tendency as purchasing power rose, for the wants and desires of some people would become more and more satisfied with every rise in their purchasing power. Taking a community as a whole, whatever be the average tendency in the exercise of purchasing power at any given moment, the average would undoubtedly change under varying conditions and varying aggregates of purchasing power, and particularly in war time. The recent war has caused an enormous change in the distribution of the purchasing power of the community, part of which change will be more or less permanent for a long period of years. In most banks there took place during the war a gradual and large transfer of credit from deposit to current accounts, obviously due to Government war disbursements mainly finding their way to the credit of manufacturing and trading accounts—a transference which was to be expected.

Whatever be the amounts of purchasing power exercised over a given short period of time by the three main classes of a community—the propertied classes (the rich), the middle classes, and the working classes—it would appear certain that over a period of years the amounts must necessarily change their proportion to one another, for the continuous struggle between capital and labour is bound to cause a varying distribution of purchasing power between the three named broad divisions of the community.

Two very simple illustrations may be given to prove how very difficult it must always be to estimate the effect of increased purchasing power on commodity prices. If several individuals be imagined to be each possessed of, say, £500 purchasing power in the form of a deposit at some bank, and each to earn or be given, say, £200, experience of human nature proves that the proportion of the £200 each person will spend in a given period of time will vary, even if prices remained stationary ; and that with each successive £200 the amount spent will vary even with the same individual. The second illustration is that it is known from experience that if

certain individuals or sections of a community exercise increased purchasing power and force up prices by competition, other individuals or sections of the same community, not possessing increased purchasing power, will voluntarily, or must of necessity, exercise less and less purchasing power—measured in quantities of goods—as prices increase.

Bearing all the foregoing considerations in mind, it may, however, be laid down as a general principle that any large amount of additional bank credit set in circulation will eventually and gradually spread itself by successive transfers over large sections of the community, and will ultimately be absorbed by the rise in prices due to the increased demands it at first created. When the additional credit is eventually widely diffused, the higher level of prices will tend to remain—unless and until followed by increased production or diminished consumption. Should loans gradually be reduced by the banks, whether outstanding on Government or civilian account, a fall in prices must eventually take place, subject to economic conditions showing little compensating variation.

Monetary inflation is obviously not always the cause of an increase in commodity prices. An increase in the proportion between the available purchasing power and the goods at the disposal of a community may be due to stationariness or a decrease in the former, but a greater proportionate decrease in the supply of the latter. In this case, reduction in supplies of available goods would be the cause of increase in prices, and not monetary inflation. During the war both factors were in operation, varying in degree of influence at different times. Another factor tending to make for higher prices during the war was the transference of purchasing power (in the form of War Loans), from persons who had no present intention of exercising it, to the Government, who required the immediate command of purchasing power. Such a transference would tend to express itself in an increase in the average velocity of circulation of available purchasing power. It is well known that at the outbreak of war the banks held a large amount of a more or less fixed class of deposits, which the owners thereof permitted to remain for years at a reasonable rate of interest, only occasionally making additions thereto or withdrawals therefrom. During the war the effect of the various War Loans was very

severely to deplete this class of deposits, which, by transference to the Government, became active instead of potential purchasing power.

If the supply of immediate available goods and services at the disposal of a community diminishes for any reason, prices rise because certain people are willing to pay higher prices sooner than go without the goods and services to which they have become accustomed. Those who cannot afford to pay the higher prices have, perforce, to reduce their consumption.

Again, when a number of people purchase a greater quantity than hitherto of any article, for no other reason than that they have a greater desire for it, and not on account of being in possession of greater purchasing power, any resulting rise in prices will obviously be due to the greater demand caused by change in desire, and not to monetary inflation.

It is not possible to state exactly to what degree monetary inflation in the United Kingdom caused, directly or indirectly, commodity prices to rise during the period July, 1914–March, 1920. Probably from 60 to 70 per cent. of the increase in prices during such period was due to monetary inflation, leaving from 30 to 40 per cent. to be accounted for by the many economic factors discussed at length in the previous chapter. From figures already given, the available purchasing power of the public was shown to have increased during the period 1st July, 1914–31st December, 1919, by, roughly, 116 per cent. During the same period the index numbers of *The Economist* and *The Statist*, representing wholesale commodity prices, increased 189 per cent. and 190 per cent. respectively, and the cost of living of working-class families, according to the *Labour Gazette*, increased 125 per cent. Close agreement between these various percentages was not to be expected, for four main reasons: (1) Part of the rise in the cost of living or in commodity prices has undoubtedly been due to economic factors. (2) There is no accurate available index number representing changes in the cost of living of the community as a whole, based on a consumption standard. (3) Part of the rise in prices was undoubtedly due to increased velocity of circulation of available purchasing power. More or less dormant deposits in banks were invested by their owners in War Loans, and such purchasing power acquired an active circulation after Government disbursements

of proceeds of War Loans. Current account balances in banks are turned over in the course of a year many more times than balances of accounts customarily classified under the heading "Deposits." In its effect on prices, increased velocity of circulation of available purchasing power is equivalent to increase in the total amount thereof. This relationship is clearly proved by the Equation of Exchange. General extravagance, as was experienced during and for some time after the war, was also another factor that increased the velocity of circulation of available purchasing power. (4) Whatever agreement economic laws demand between various percentages in normal periods is not to be expected in transition periods. Some of the elements or magnitudes have greater momentum or "lag" than others during periods of transition, owing to various reasons. Psychological influences have a greater effect on the course of prices when credit is rapidly expanding than when the amount of available purchasing power is fairly constant. Such influences tend to cause a further rise in prices for some months after further inflation has practically ceased. And when credit is being contracted the reverse is the truth.

During the year 1920 there was a further increase in the amount of available purchasing power of between £170,000,000 and £180,000 000 (exact amount not ascertainable). Comparing figures at 31st December, 1920, with figures at 30th June, 1914, the available purchasing power increased about 128 per cent., *The Economist* index number 132 per cent., *The Statist* index number 155 per cent., and the cost of living of the working classes, according to the *Labour Gazette*, 165 per cent. These percentages, it will be observed, are in closer agreement than those already given for 31st December, 1919. This was to be expected, for it is known that the velocity of circulation was less at 31st December, 1920, than a year previously, partly on account of the trade depression which set in during the last six months of 1920 and partly because there was considerably less general extravagance, following growing unemployment.

It would appear that the best index of any great change in prices of goods and services, over short periods of a few years, would be variation in the amount of the currency in active circulation (exclusive of currency in bank reserves), subject to an allowance being made for any change in velocity of circulation, if both factors

could be accurately ascertained. The comparison should be made preferably over a short period of years, in order to eliminate, as far as possible, any serious error being introduced through increasing use being made of cheques as the form of settlement and material variation in population.

The following questions having been repeatedly raised in the Press, by various writers and speakers since 1915, replies are given to each below, notwithstanding that such questions have been answered in a general sense by what has already been written on the subject of prices in this and the previous chapter.

(1) How far is the rise in prices since July, 1914, due to (*a*) the expansion of the currency, and (*b*) expansion of credit ?

In the early stages of the war, economic factors, such as intensified demand for available supplies (the Government became a great consumer for war purposes) caused prices to rise. The higher prices, the urgent necessity for the maximum production possible under war conditions, and the scarcity of labour compelled employers to grant requests for higher wages. The greater costs of production and higher prices of necessary imports at a later stage compelled employers and traders to seek additional credit at the banks. Part of the increased costs of production and of the cost of goods generally was due to considerably increased profit margins being demanded by producers, manufacturers, and traders. The larger profits, rendered possible by demand being in excess of supply, and rising prices, were an incentive to manufacturers and traders to seek further bank loans. When the Exchequer receipts—the proceeds of taxation and of War Loans—were insufficient to meet war expenditure, the Government obtained grants of credit from the Joint Stock Banks (in the form of subscriptions by the banks to War Loans, Treasury Bills, etc.) and Ways and Means Advances from the Bank of England. The points to note are that : (*a*) If the Government had been unable to obtain loans from the banks, it would have been compelled to obtain further loans from the general public, and would have shown a greater determination to resist demands for increases in wages. In this event, there would have been less civilian demand for commodities. (*b*) If manufacturers and traders had not been able to obtain further loans from the banks, there would have been a lesser demand for available supplies of materials and finished goods, and,

consequently, a lesser rise in prices. Furthermore, they would, perforce, have had to refuse further requests for higher wages. (*c*) If wages had been less, the civilian demand would have been reduced, and, consequently, there would have been a lesser rise in prices. (*d*) If the Government had not borrowed from the Bank of England, Joint Stock Bank balances at the Central Institution would have been less than they actually were and such banks, on account of diminishing percentage cash reserves, would have been less willing to accede to requests for further loans.

The issue of Currency Notes was a very minor direct cause of the rise in prices. The fiduciary part of the issue provided the Government with an equivalent amount of purchasing power, and increased Joint Stock Bank balances at the Bank of England. After the initial rise in prices due to economic causes the issue of such notes was essential in the absence of large imports of gold being devoted to currency requirements, or a considerably increased use being made of cheques for settlement of retail transactions. If the issue of Currency Notes had been restricted, the Joint Stock Banks would have been compelled to restrict the expansion of credit. The greater part of the issue of Currency Notes were drawn and retained in circulation by higher wages being paid and continuously rising prices, both of which were mainly dependent on an expansion in bank credit. Each successive increase in bank credit permitted higher wages to be paid, higher profits to be taken, and was, therefore, a powerful influence in contributing to the prolonged rise in prices. If there had been no increase in bank credit since 1914, there must have necessarily been a reduction in civilian consumption of commodities. Prices would have tended to rise through economic influences, but a limit must have soon been reached when demand met supply at the higher price level. It may therefore be said that the major part of the rise in prices since July, 1914, was indirectly due to the expansion in bank credit, that a fairly large part was due to economic influences, but only a very small part was directly due to the issue of Currency Notes, though such issue was a necessary accompaniment to the expansion in bank credit.

(2) Is the expansion of credit the cause or the effect of the expansion of the currency?

From what has been already said, it is obvious that the expansion of credit was the main indirect cause of the expansion of the currency.

(3) Was it possible in this and other countries to prevent the expansion of credit and currency?

The major part of the expansion of credit and currency was undoubtedly preventable or unnecessary if the various Governments of the belligerent nations had conscripted the factors of production for the period of the war on the same basis of remuneration as paid to the fighting forces; and also introduced compulsory subscriptions to War Loans when voluntary subscriptions fell short of the required amount. Some part, possibly about 33 per cent., of the expansion of credit was necessary on account of the increase in prices of essential imports for civilian consumption, unless there had been a compensating reduced consumption of commodities. It may also be said that about 33 per cent. of the actual increase in currency was necessary on account of rising prices due to unpreventable economic causes under war conditions and the essential part of the increase in bank credit. The Governments of all the belligerent Powers neglected to observe the basic economic principle that war conditions demand reduced civilian consumption, in the absence of considerable expansion in production, preferring, instead, to choose the easier policy of unprecedented inflation, with all the cumulative attendant evils to be reaped during many years after the conclusion of peace. The recent war was essentially a contest between the material resources of the various Powers engaged in it, as has been abundantly proved by its aftermath. If available purchasing power had not been greatly increased during the war, there must necessarily have taken place reduced civilian consumption, which war conditions demanded on economic grounds.

The table, on page 284, which appeared in a Board of Trade return (Cmd. 734) issued in 1920, shows a comparison of expansion in currency with rise in prices in various countries since 1913.

The comparison is necessarily rough, and therefore no close agreement of percentages was to be expected, on account of the impossibility of ascertaining the exact amounts of currency in the hands of the public and of measuring changes in velocity of circulation, and the want of index numbers calculated on a consumption basis. Still, the somewhat close agreement, in the

case of some of the named countries, between the percentage increase in retail prices of food and in currency is interesting. The cost of foodstuffs is, in reality, the basic cost of all materials and finished goods, if world-wide prices be considered in normal times.

COMPARISON OF EXPANSION IN CURRENCY WITH RISE OF PRICES IN CERTAIN COUNTRIES

—	Currency of all kinds. 1913 = 100.	Wholesale Prices. 1913 = 100.	Retail Prices[1] of Food. 1914 = 100.
United States (March, 1920 .	177	253·0	196
United Kingdom (March, 1920)	250[2]	321·8	235
Switzerland (December, 1919).	253	—	237
Denmark (January, 1920) .	255	—	251
Japan (October, 1919) . .	274	266·3	—
Sweden (March, 1920) . .	275	354·0	291
Netherlands (February, 1920) .	290	—	199
Norway (February, 1920) .	305	—	294
France (February, 1920) .	400	522·4	Paris 297
Italy (December, 1919) .	565	452·6	252

Evils of Inflation

The evils resulting from a policy of inflation are many and cumulative. Some of the more important are enumerated below, from which it will be observed that several do not disclose themselves until further inflation is checked—

1. Inflation being the indirect cause of a great rise in prices, producers, manufacturers, traders, and retailers during the rise reap large profits at the expense of the consumer, for stocks, simply by the act of holding, are continuously increasing in market money values.

2. Social discontent and labour troubles arise partly through knowledge that capital is receiving undue profits, and partly on account of the resultant rise in the cost of living.

[1] The fact that retail prices of food have risen less than general wholesale prices is in part attributable to the control of prices by Governments extending, in certain cases, to the maintenance of retail prices below cost of production by means of subsidies.

[2] In the case of the United Kingdom, the circulation at the end of March, 1920, is compared with the circulation at the outbreak of the war.

3. Demands are naturally then made by labour for increased wages, with intermittent strikes to enforce such demands. With each increase in wages, there takes place a further rise in the cost of living, to be followed by new demands for increases in wages, and the usual vicious circle comes into operation.

4. Labour becomes so imbued with the money rate of wages, and not the real purchasing power of same, that discontent and strikes invariably arise later when the inevitable reaction in prices occurs and the increased wages cannot be maintained on economic grounds.

5. The fixed income class are compelled to suffer a considerable reduction in the purchasing power of their incomes ; likewise those whose incomes have not increased proportionately to the rise in the cost of living. The net effect of inflation to such classes is that part of their incomes is taken from them and distributed over the producing and trading classes and labour, particularly the former. Excessive inflation invariably causes widespread changes in the distribution of the national income.

6. Artificial prosperity is created, which at all times is bad for the community. Extravagance among certain classes becomes rampant.

7. Governing authorities have no option but to increase taxation and local rates, on account of the greater cost of maintaining public services and of materials.

8. A very large part of the cost of the recent war to Great Britain was due to the policy of inflation adopted by the country. The enormous addition made to the National Debt during the war will prove an increasing burden to posterity as the home currency appreciates in terms of goods and services.

9. The rise in production costs, following inflation, weakens the competitive power of the country in foreign trade, unless inflation has taken place proportionately, or to a greater extent, in competitive countries. Great Britain being largely dependent on her export trade for the absorption of a great part of her labour, and for the means of payment for essential imports of foodstuffs and raw materials, excessive inflation in her case is ever a national danger. For this reason it may truly be said that Great Britain should have been the last country to embark on a policy of inflation during the recent war. The state of production within the United Kingdom is obviously closely connected with the

volume of the export trade of the country, which in its turn is largely dependent on home costs of production relative to such costs in other competitive countries.

10. The effect of inflation on the body politic is similar, in some respects, to the effect of drugs on an individual who has acquired the pernicious habit of taking drugs—further and increasing doses are found to be necessary to maintain reasonable contentment, but successive increases only make the collapse, when it eventuates sooner or later, all the greater. Prices during 1915-1919 had gained such an upward momentum by continuous unprecedented monetary inflation, that, in a sense, at the end of 1919 they had anticipated further doses of inflation.

11. One of the worst evils of inflation is that it is impossible to check or reverse the process without causing grave social evils and widespread unemployment. When eventually checked, a cumulative landslide in prices is inevitable, to be later followed by undulations diminishing in degree until a level is established in consonance with current economic and financial conditions.

12. Psychological influences during a period of rising markets force prices higher than is warranted by the existing quantity of available purchasing power. Consequently, when inflation is checked, and notwithstanding there is no immediate reduction made in the then outstanding amount of available purchasing power, a reaction in prices is soon inevitable. The fall, however small to begin with, is immediately followed by many cumulative evils, quickly increasing in strength, and all of which tend to make the initial fall develop into an avalanche. Stocks are thrown on the markets, and the public, retailers, merchant houses, and manufacturers cease making or reduce in quantity immediate purchases of finished goods or raw materials, as the case may be. Attempts are made to cancel existing contracts. Credit becomes strained, and a large part becomes solidified in high-priced stocks and doubtful book debts. Commercial and financial difficulties become prevalent and, consequently, forced realizations. D cannot pay E because C cannot pay D. C cannot pay D because B cannot pay C. B cannot pay C because A cannot pay B. A cannot pay B because there is a reduced public demand for high-priced goods, and therefore there is a general retardation in the usual rate of flow of credit. At this stage unemployment increases.

The postponement of purchases of commodities by the consumer, and the part solidification of bank and commercial credit, reflect themselves in a reduction of the average velocity of circulation of the total available purchasing power of the community.

The fact that a severe fall in prices has taken place since April, 1920, not preceded or accompanied by any material reduction in the total available purchasing power of the community, is clear proof of the impossibility of checking or reducing excessive inflation without causing great social and economic disorders. If reference be made to the Equation of Exchange (already discussed), it will be obvious that the fall in prices since the above-named date must have been accompanied by a material reduction in the average velocity of circulation of available purchasing power, for, up to the time of writing, there has been no great reduction in the outstanding amount of bank credit nor of currency. The volume of commodities within the United Kingdom has, however, probably slightly increased since April, 1920, but no data is available from which to make a comparison.

13. During a period of reaction, following excessive inflation, raw materials fall in price proportionately more than finished goods. Manufacturers naturally hesitate to make for stock when conversion costs are high and there is every probability of a material fall in such costs in the near future. They have always to bear in mind future competition from other manufacturers producing at a later date at lower conversion costs.

14. When a fall in prices commences after a period of excessive inflation, it has to run its full course. The fall is obviously accelerated by reduced purchasing power of the working classes consequent on working short time or growing unemployment. Prices after a period of great inflation usually fall below a level warranted by current economic conditions and costs of production. Eventually, however, a stage is reached when public demand exceeds supply owing to reduction in prices and scarcity of available commodities arising from diminished production. A reaction in prices to a higher level is at this stage inevitable, resulting in a minor trade boom. Thereafter, during the painful process of deflation there take place intermittent falls and rises, but the general tendency in the level is downwards until deflation is more or less

complete, in the absence of economic influences causing scarcity conditions.

15. Inflation, it has been shown, is succeeded by periods of unemployment, which is an irretrievable waste of potential energy. Such waste retards a raising of the standard of living. Unemployment is at all times a waste of potential energy which ought, on economic grounds, to be absorbed in augmenting the factors of production.

16. During periods of widespread unemployment there is ever present a danger of grave social disorders, destruction of property, and conditions bordering on revolution.

17. Periods of falling prices, or the possibility of a fall in the near future, destroy confidence, which is the basis of credit and industry.

18. Excessive inflation during 1915-1919 in the United Kingdom and in other countries was the root cause of the great financial and commercial difficulties and bad trade throughout the world during the greater part of 1920 and 1921. A large proportion of retailers, merchants, and manufacturers adopted a waiting policy (in some cases unavoidable on account of financial difficulties) until high-priced stocks were absorbed by consumption before ordering or manufacturing any large quantity of new stocks. The widespread disinclination shown by retailers and merchant houses to reduce prices of existing stocks to a level justified by replacement cost considerably retarded the rate of consumption by the public. It has been a short-sighted policy, for whatever losses had to be temporarily faced by retailers in selling below cost their high-priced stocks, they would soon have compensated themselves for such losses by a considerable greater turnover with new stocks purchased at lower replacement costs. Before the war it was generally considered to be bad business for a trader to find himself left with unrealized stocks to face a new season and a lower range of prices.

Probably no better illustration of reaping the inflation harvest can be given than the following comment on the general economic position, extracted from the March, 1921, number of the *Monthly Bulletin of Statistics* issued by the Supreme Economic Council—

> The most recent statistics available afford some indication of the seriousness of the industrial depression prevailing throughout the world. The production

of such important commodities as coal, pig iron, crude steel and sugar are considerably below the quantities available in the year 1913. Shipbuilding is stagnant. Imports and exports, measured by value, show a declining tendency. Orders are held back in view of the present high prices and in anticipation of material reductions in the near future. The fall in freights and the decline in cargo offering have caused shipowners to lay up many vessels. In most countries the amount of paper money in circulation has undergone but little reduction. Unemployment is serious in extent and in magnitude, and appears to be increasing. Wage reductions and the working of short-time are reducing the purchasing power of the people in many countries.

The rapid increase in unemployment since September, 1920, is clearly shown by the following table, the figures of which have been extracted from the *Labour Gazette*. The percentages, it is to be noted, refer to unemployed members of trade unions (mainly of skilled workers)—

TRADE UNION UNEMPLOYMENT PERCENTAGES

	1913.	1916.	1917.	1918.	1919.	1920.	1921.
End of—	%	%	%	%	%	%	%
January	2·2	0·6	0·3	1·0	2·4	2·9	6·9
February	2·0	0·5	0·3	0·9	2·8	1·6	8·5
March	1·9	0·5	0·3	1·2	2·9	1·1	10·0
April	1·7	0·5	0·3	0·9	2·8	0·9	17·6[1]
May	1·9	0·5	0·4	0·9	2·1	1·1	22·2[1]
June	1·9	0·5	0·4	0·7	1·7	1·2	23·1[1]
July	1·9	0·4	0·4	0·6	2·0	1·4	—
August	2·0	0·4	0·5	0·5	2·2	1·6	—
September	2·3	0·4	1·3	0·5	1·6	2·2	—
October	2·2	0·3	1·1	0·4	2·6	5·3[1]	—
November	2·0	0·3	1·1	0·5	2·9	3·7	—
December	2·6	0·3	1·4	1·2	3·2	6·0	—

Other particulars furnished by the *Labour Gazette* show that 2,171,288, or 17·8 per cent. of the 12,200,000 workpeople insured under the Unemployment Insurance Act were totally unemployed on 24th June, 1921. In addition, on the same date, 832,340 males and females were registered as working systematic short time to such an extent as to entitle them to benefit under the said Act or the Out-of-Work Donation Scheme. The above figures, it is to be observed, up to March, 1921, represent the state of unemployment before the recent coal stoppage, which commenced on 31st March, 1921, and terminated at the end of June.

[1] Excluding coal miners.

Another indication of the almost world-wide trade depression, following excessive inflation, is to be found in the condition of British shipping in April, 1921. In that month there was laid up in idleness over one-half of the overseas and coastwise tonnage of the United Kingdom, notwithstanding a reduction in freight rates of 70 to 80 per cent. since the early months of 1920.

One of the most unfortunate results of the great increase in unemployment, following the severe fall in prices, is that it has confirmed a number of the rank and file of labour in their opinion, particularly held during the boom period, that the less the output of each individual member, the less the extent of unemployment, and higher wages for all. To urge a policy of increased output at a time when there is a great amount of unemployment naturally appears to labour to cover some ulterior motive than benefit to themselves and the general consumer. The most opportune time to convince labour of the error of the ca' canny principle, as being of ultimate benefit to themselves, would appear to be when the greater part of present stocks of high-priced goods have been absorbed by consumption, and unemployment is steadily diminishing. Unfortunately, capital is not altogether free from blame in adopting a policy of restricted production, or withholding of raw materials from the market during a period of rapidly falling prices, when the adoption of such a policy will minimize losses or increase future profits.

Maximum output, without unduly impairing health, and an equitable distribution of the products of industry, is the ideal to be aimed for by all classes, whether their labour be physical or mental.

CHAPTER XII

COMMODITY PRICES—THEIR PROBABLE FUTURE COURSE

THE previous two chapters were devoted to explaining the many and varied causes of the unprecedented rise in prices during August, 1914–March, 1920, and the rapid, though partial, fall since April of last year up to the time of writing. For obvious reasons, there is probably no matter that is more seriously, at the present time, engaging the minds of the purchasing public and of traders, and the attention of the Government, than that of falling prices, and the uncertainty as to how far the fall will go in the future. The purchasing public is naturally most interested in experiencing a rise in the purchasing power of the pound, as measured in quantities of goods. All classes of producers and traders are more directly concerned about the extent of a further fall in prices on account of experiencing considerably lesser profits, in many cases having to face considerable losses through fall in values of stocks and bad debts, and in the welfare of their workpeople when mills have to be shut down for a long period or run on short time, until equilibrium is more or less again established between demand and supply.

The Government's concern in a further and prolonged fall in prices is the serious problem of growing unemployment, giving rise possibly to grave social disturbances. Diminished receipts from Income Tax and other sources of revenue is comparatively a small matter.

The present chapter will therefore be devoted to considering various reasons for thinking that the bottom of the fall in general prices has not yet been reached, and that it will continue yet for some considerable time. The extent of the ultimate fall in prices, and the period of time over which it will take place, must necessarily be a matter of individual opinion. The writer of this[1] considers that general prices will continue to fall, with intervening stationary periods or relatively small rises, when demand temporarily meets

[1] Mr. A. H. Gibson.

or exceeds supply, for a period of about five years. By the end of that time, he thinks that the average level of wholesale prices will not be more than 25 per cent. above the pre-war level of 1913.

The reasons for thinking that the bottom of the fall in prices has not yet been reached and that the fall will continue for some considerable time, until an average level of prices is reached not materially higher than the pre-war level, are given below—

(1) In a previous chapter it has been shown that the fall in prices, since April of last year, has been largely due to a reversal or removal, in whole or in part, of the economic influences that contributed to the rise that took place between August, 1914, and April, 1920, accelerated by unexpected cancellations of orders, following the revolt of the consumer against high prices and falling markets, and also reduced purchasing power of certain sections of the community consequent on a large volume of unemployment. The checking of further inflation during 1920, and the imposition of a high Bank Rate, had some material influence in starting or accelerating the downward movement in prices. Since the war terminated, labour has returned from non-productive to productive industry. Further loans to Allies and Dominions have practically ceased, except for increase due to capitalization of interest on certain of the loans. There has been a considerable fall in the prices of raw materials, which must in time greatly reduce the costs of production of finished goods. Certain other costs have fallen, but others have risen. Turnover margins of gross profits have necessarily had to be reduced in falling markets. Psychological influences have operated strongly in the direction of a fall. The consumer has revolted at high prices, and has deferred purchases in view of falling markets. The manufacturer, merchant, and retailer have, in many trades, ceased increasing stocks. Generally speaking, they have endeavoured to reduce stocks in view of falling markets. Some mills have been closed for want of orders and others are running short time. Increased taxation cannot be so completely passed on to the consumer in the prices of commodities during a period of falling prices as in a period of rising prices and keen demand for available stocks. There has been a considerable improvement in the despatch of goods, less congestion at docks and railways, and an increasing amount of mercantile tonnage available. Marine insurance rates have fallen,

and there has been a great reduction in freight rates. The prices of several important commodities imported from abroad have fallen, and all indications point to a further considerable reduction in the near future, particularly in foodstuffs. The foreign exchange rates, as a whole, have become more favourable to the United Kingdom, though sterling still remains at a discount in a few countries, particularly in the United States. Finally, there has taken place some resumption of the usual channels of international trade. It was obvious to all students of economic history that a fall in prices would set in some time during the year 1920, particularly in view of the decision of the Government, towards the close of 1919, to endeavour to stop further monetary inflation. During the next few years there will be a further considerable liquidation of the influences that contributed to the rise in prices and artificial prosperity between August, 1914, and April, 1920, and though their complete removal will probably never be effected, yet there are certain compensating factors to take into account. Wages will certainly fall as a consequence of unemployment. The extent of the fall will be largely governed by the productivity of labour and costs of production in foreign countries. Labour leaders will later inevitably have to recognize the changed economic conditions. It is to be hoped that real wages will never be forced back to their pre-war level, particularly to the low rates ruling in certain industries, but there is every reason to believe that economic forces and foreign competition, by 1925–1927, will have forced a reduction in present rates of wages to 50 per cent. above pre-war rates. This increase can easily be maintained with greater production. Fortunately, several labour leaders are increasingly recognizing the benefits of increased production to labour itself, and it is to be hoped that in the course of time they will be able to inculcate this great economic truth into the ranks of labour. Greater application of machinery and other aids to production can alone permit wage rates to remain at 50 per cent. above pre-war rates and the cost of living not to be more than 25 per cent. above the pre-war level, assuming no change in the standard regimen. A general recognition by labour of the great distinction between real wages and money wages, and the usual vicious circle when a rise in money wages is not accompanied by proportionate increased production, would hasten the economic rehabilitation of the country

and eventually lead to a higher standard of living and greater general contentment.

All economic history proves that the cost of foodstuffs, for man and beast, regulates, directly or indirectly, the ultimate cost of commodities in general consumption. It is the basic cost of almost everything, unless a commodity rises in price on account of unusual scarcity. A considerable fall in the prices of foodstuffs has already taken place in America and certain other countries, and a partial sympathetic fall in the prices of foodstuffs within the United Kingdom. A further fall is to be expected in the near future. Excellent harvests are reported in several countries.

(2) If the war had not taken place, there is every reason to believe that there would have been a fall in commodity prices since 1914. As pointed out in a previous chapter, an influence of great importance, and likely to be of long duration, had commenced to operate to reduce commodity prices about a year before the commencement of the war. This influence was largely suspended or nullified by the indirect effects of hostilities, but it will assuredly make itself felt in the future. Owing to the enormous amounts of capital attracted during 1907–1913, in particular from the United Kingdom, to food and raw material producing countries, there must have necessarily followed, under normal conditions of peace, a considerable increase, for many years to come, in the world's production of foodstuffs and raw materials. Consequently, a fall in commodity prices appeared to be inevitable sooner or later. Index numbers show that during the period 1875–1896 there took place a great and almost continuous fall in commodity prices, Sauerbeck's index number for 1896 being 61 as against 102 for 1874, which number was also the average figure for 1865–1874, the fall being mainly due to the rapid development during the seventies and eighties of the young food and raw material producing countries. From 1897 to 1913, with the exception of two breaks, there was a considerable rise in commodity prices, the index number for 1913 being 85, as against 61 for 1896. This natural rise in commodity prices once more attracted enormous sums of capital to the food and raw material producing countries. From the United Kingdom alone, over £1,000,000,000 were attracted into foreign and Colonial investments during 1907–1913, a period of but seven years, one-half of which capital was devoted to productive railway

construction. That this newly invested capital was not able to make itself fully felt in net increased production during the war is obvious, on account of scarcity of labour in many countries. In the case of the British Colonies, a scarcity of labour was felt during the war, owing to the large number of Colonials who fought for the British Empire.

(3) One of the main reasons, if not the greatest, for thinking that there will be a fall in prices during the next few years to a level not materially higher than the level ruling just prior to the war, say during 1913, is a study of the course of prices after wars in the past. Great wars have ever been a powerful factor in raising commodity prices, in the main obviously due to the feeding, clothing, and transport of armies, and armament requirements, necessitating greater production at a time when large numbers of men are withdrawn from the ranks of productive industry for fighting purposes, and for performing services accessory to fighting. Inset there is given a chart showing the course of wholesale commodity prices as far back as 1782 and up to 30th April, 1921, with references to various wars and other disturbing events, the bottom curve being plotted in continuation of the top curve. These curves clearly prove that prior to the recent war the greatest disturbing event to the course of commodity prices in the past was the series of wars with France (Napoleonic), extending from 1793 to 1815. These terrible wars finished with the Battle of Waterloo, 18th June, 1815. From a study of the curve for the fifty years 1785–1835, there may be drawn the following important points—

There was a rapid though fluctuating rise in commodity prices during the Napoleonic Wars, the maximum point being reached in 1809. During the next five years, England fought the French on Spanish territory, and for some reason commodity prices fell during this period. In 1816, a year after the close of the Napoleonic Wars, prices on an average were almost normal, but there was a bad harvest for this year. Riots took place during 1816–1818, and prices rose again. They fell once more after 1818, becoming normal during 1822–1824. The cheapness of money in 1824 led to inflation in 1825, to be followed in the same year by a serious commercial and financial crisis. Prices were again normal during 1828–1835. After 1835 the course of commodity prices was

affected by a large number of events and causes, the most important of which are indicated by the letterpress particulars on the chart. These particulars show that war has usually had some material effect on prices, and that the great and prolonged fall in prices during the seventies and eighties of the last century was mainly due to the rapid development of young food and raw material producing countries. It is worthy of note that prices during 1918, 1919 and 1920 reached a higher level than at any time during the Napoleonic Wars, and therefore the question arises: Will not the present fall be all the more severe until a new level is established that, more or less, conforms to post-war conditions? The population of the United Kingdom has increased since the Battle of Waterloo by about 150 per cent., but the National Debt about 900 per cent.

(4) Another factor that will inevitably force prices down in the future, and tend to keep them down, will be the deflation later of credit and currency by the banks and the Government. This influence has hardly yet commenced to operate, and there are obvious reasons, with rapidly falling markets, for postponing it and making its effect felt later as slowly as possible. It is sufficient for the time being to have checked further inflation. It is interesting to note, however, that a prolonged period of falling prices effects, of itself, part deflation of credit and currency, for a lower level of prices reduces the demand for bank credit (as measured by the aggregate amount), and impels a return of currency from internal circulation. Gradual liquidation of old book debts (created during the period of high prices) will also reduce the demand for bank credit. All past experience has proved that a period of falling prices is followed within a period of two years by a greater demand for high-class investments. As soon as Government stocks approach their original subscription prices, the banks will proceed to sell a large part of the investments they acquired during the war. This action will accelerate deflation by reducing the available purchasing power of the community. With an increased demand for gilt-edged investments the Government will take the opportunity to fund the greater part of the Floating Debt, which is ever a potential danger to the money market. The effect of Government repayments of Ways and Means Advances will be to cause further reduction in the so-called cash balances of the

Joint Stock Banks at the Bank of England, but such reduction will probably be compensated for by a reduction in the amount of Joint Stock Bank advances to own customers (mainly due to falling commodity prices being followed by a lesser demand for bank credit, particularly after present stocks have been absorbed by consumption), and in the amount of investments at present held by the banks. Consequently, there is every reason to believe the Joint Stock Banks will be able approximately to maintain their pre-war customary cash reserve percentage to liabilities during the period of falling prices.

Summing up, the reasons for thinking that commodity prices in the course of a few years will not be materially higher than the pre-war level (in the absence of any further great war, grave and prolonged social disturbances, or a series of bad harvests) are as follows—

(1) The almost complete reversal or liquidation of the operating causes for the rise during August, 1914–April, 1920, except the increased wages and increased taxation. Both wages and taxation will, however, fall in the course of time, though not to pre-war levels ; but the increase remaining will probably be compensated for by improved methods of production, and greater output per man, per hour.

(2) The fructification of the large amount of capital that was attracted to food and raw material producing countries during the seven years 1907–1913, the influence of which was largely suspended or nullified during the recent war by the indirect effects of hostilities.

(3) The lesson of economic history. The rapid fall in prices to a normal level soon after the termination of the Napoleonic Wars.

(4) The gradual deflation of credit and currency, part of which will be effected automatically as prices fall, and part later by the action of the Government and the banks.

It is an interesting question whether the average level of prices may not, in the course of time, say, at the end of ten years, even fall below the immediate pre-war level. Any such probability is obviously closely connected with the future production of gold, the restoration of gold currency (or gold backing of paper issues), and the attitude of banks in the matter of again making this metal

the main constituent of their cash reserves. From 1891 to 1909 the production of gold rapidly and continuously increased, from £27,000,000 in 1891 to £94,000,000 in 1909. During 1910–1916 there was a stationary tendency in gold production, and since 1916 a rapid decrease has been experienced, the value for 1920 being only about £70,000,000. Allowing for increase in population, the restoration of the gold standard in various countries in the course of ten years, and a gold basis for bank credit, will require an annual production of gold of at least £120,000,000.

DEFLATION

As brief reference has been made to the subject of deflation, and as the degree to which it is effected will be a determining influence of the ultimate level of prices, it will be advisable to consider the subject more in detail.

Deflation, which is the converse of inflation, can obviously be effected by four main processes, namely, reduction in the purchasing power of the community, funding of the present floating debt by direct subscriptions from the public and not from the banks, further retrenchment in public expenditure, and intensified production.

The purchasing power of the public can be reduced by the following methods—

(*a*) By the banks experiencing or effecting a reduction in the amount of their outstanding loans, whether in the form of money at call or at short notice, bills discounted, or the customary form of advances. Any reduction in the aggregate of loans can only be effected by a corresponding reduction in the aggregate of deposits, taking the banks collectively. Cheques drawn on credit balances must necessarily be the form of any considerable liquidation of bank loans of whatever nature.

(*b*) By the banks placing on the market part of the investments they acquired during the war. Generally speaking, the purchasers will, in payment, give cheques drawn against credit balances and consequently the aggregate of deposits will tend to be reduced. The same effect will tend to be produced when the banks do not take up new Treasury Bills to replace maturing Treasury Bills, or do not replace any other form of Government investment at date of redemption. In these two cases the agent reducing deposits

will be customers' cheques for taxation or for some form of Government borrowing from the public.

(*c*) By the Government making repayment to the Bank of England of Ways and Means Advances, and also reducing the amount of outstanding Treasury Bills by the proceeds of taxation or long-dated loans subscribed for by the general public. Taxation and subscriptions by the public to Government loans paid for by cheques drawn on credit balances obviously reduce the aggregate of deposits, and consequently the available purchasing power of the public. The Government, by repayment or reduction of Ways and Means Advances made by the Bank of England, necessarily reduces the balances of the Joint Stock Banks at that bank, and consequently compels, sooner or later, the banks to reduce their deposit liabilities to their customers by the methods already enumerated, unless sufficient reduction has been effected automatically by a lesser demand for credit consequent on a lower level of prices. Unfortunately, during the past two years, when the banks have allowed Treasury Bills in their portfolios to run off, and have not replaced them by new Treasury Bills, the Government has been compelled to partly meet the maturing bills by an increase in Ways and Means Advances. So long as the banks hold Treasury Bills, they can always, by omitting to replace them at maturity, increase their cash reserves temporarily at the Bank of England, or withdraw Currency Notes from that institution.

(*d*) By the Government reducing gradually the fiduciary issue of Currency Notes. As this action, failing a reduction in the amount of such notes outstanding, can only be effected by replacement of Government securities in the Currency Note Redemption Account by gold or Bank of England Notes covered by gold, the adoption of this policy will tend to maintain fairly high Bank Rates in the future, and indirectly, through the fall in prices that usually takes place during the continuance of high rates for loans, cause a return of Currency Notes from circulation. High Bank Rates operate in several ways in the curtailment of credit.

The most important effect, however, that a reduction in the fiduciary part of the issue of Currency Notes will have on the banking position will be to tend to cause a reduction in the cash reserves of the Joint Stock Banks. To make this important matter clear, let it be assumed that the Government, out of the proceeds

of taxation or loans direct from the public, substitutes, say, £50,000,000 of gold or Bank of England Notes for Government securities at present standing to the credit of the Currency Note Redemption Account. The series of transactions or book entries would then be as follows—

Customers of Joint Stock Banks draw cheques on their accounts for taxation payments or loans to Government for £50,000,000.

Customers' accounts at Joint Stock Banks debited £50,000,000.

Joint Stock Bank balances at Bank of England debited £50,000,000.

Public deposits at Bank of England credited £50,000,000.

Public deposits at Bank of England debited £50,000,000, because the Government orders a transfer of such amount in gold or Bank of England Notes to credit of Currency Note Redemption Account, cancelling, per contra, the same amount of its own securities.

Net effect of such transfer to Bank of England and Joint Stock Banks—

Bank of England loses £50,000,000 in gold or in own notes, taken from its banking reserve. Other deposits reduced by £50,000,000.

Joint Stock Bank balances at Bank of England reduced by £50,000,000 and credit balances of customers of Joint Stock Banks reduced by £50,000,000 (unless, and to the extent of, the taxation payments or loans to Government are made out of further grants of credit to customers).

To the extent that Currency Notes are paid into Joint Stock Banks by their own customers, their cash reserves will tend to be increased. The fall in retail prices and wages will cause a return of Currency Notes from public circulation to the Joint Stock Banks, who in their turn will pay in part or the whole of such returned notes to the Bank of England to the credit of their own balances thereat.

For reasons stated above it is obvious that in the matter of having eventually to decide whether or not to enforce deflation, the banks will not altogether be free agents. Their policy will necessarily have to be largely determined by the percentage their cash reserves bear to their deposit liabilities. In reviewing in a previous chapter the banking position during the war, it was pointed out that the so-called cash reserves of the Joint Stock Banks had been, in a sense, artificially increased during the war

by certain credit operations between the Government, the Bank of England, and the Joint Stock Banks. The reversal of such operations under peace conditions will, by mere book entries, reduce the cash basis on which rests the great increase in bank credit made during the war. Again, should the Joint Stock Banks aim at restoring a gold basis to their deposit liabilities, enforced deflation will be necessary for the fulfilment of this object. The period within which a 7 per cent. gold reserve could be accumulated will obviously be dependent on the future production of gold and the competition for available supplies of the metal from other countries, both of which are indeterminable factors at the present time. Whatever be the amount of future imports of gold into the United Kingdom, the operation of the exchanges will tend to drain a large proportion of it away to foreign countries (should such countries want gold) unless protected by fairly high home interest rates.

The degree to which forced monetary deflation will eventually have to be made by the banks will also be largely dependent on the attitude pursued by labour in the matter of general intensified production. Should there be a considerable increase in production (in quantity), a large part of the additional purchasing power created since 1914 could remain, and yet prices fall to a level not materially higher than that ruling prior to the war.

Since the fall in prices commenced in April, 1920, and up to the time of writing (May, 1921), it cannot be said that any net monetary deflation has taken place. On 30th April, 1921, in round figures, the floating debt amounted to £1,290,000,000 (Ways and Means Advances £190,000,000, and Treasury Bills £1,100,000,000) as against £1,297,000,000 (Ways and Means Advances £249,000,000, and Treasury Bills £1,048,000,000) on 1st May, 1920. Currency Notes (including Certificates) outstanding on 4th May, 1921, amounted to £338,000,000 as against £343,000,000 on 5th May, 1920. Bank deposits increased £150,000,000 during 1920, but some reduction, approximately £130,000,000, took place during the four months January–April, 1921.

CHAPTER XIII

SECURITY PRICES

In the three previous chapters the subject of Prices since the commencement of the recent war was considered in relation to commodities. The present chapter will be devoted to a brief review of the movements that have taken place during the same period in the values of Stock Exchange securities. The values of such securities may be considered from two standpoints: first, the market price of the parity amount of the stock or bond, or of the share; second, the yield, per annum, at the market price of the security. In the case of fixed interest-bearing securities, the yield obviously varies proportionately but inversely to the market price. In the case of shares, whilst their market values tend to be in rough sympathetic movement with the prices of fixed-interest bearing securities, such values are naturally largely determined by the dividends previously declared thereon, and the probability of any change in the amount of dividend in the near future. In this book it will not be possible to discuss the various changes made in the amount of dividends paid on shares since 1914, and, consequently, the subject of change in values of securities will be considered from the market price standpoint.

The best and most reliable record of the course of the market values of general securities is that published monthly in the *Bankers' Magazine*. Changes in the market values of 387 representative securities (classified into various groups), with an aggregate nominal amount (par value) of £3,424,586,000, have been calculated and published each month by this magazine since 21st January, 1907. On that date the market values of these securities aggregated to £3,843,177,000. Previous to 1907 the valuation was made with a lesser number of securities. The table given on page 304 shows the market values at 20th July, 1914 (just before the recent war), compared with those ruling on 20th December, 1920, this latter date being chosen because it shows the lowest aggregate market value[1] recorded by the *Bankers' Magazine* since 1907.

[1] Since this chapter was written, and up to the time of going to press, a slightly lower aggregate market value of £2,284,962,000 at 19th April, 1921, has been recorded by the *Bankers' Magazine*.

The previous lowest valuation amounted to £2,571,612,000 on 18th April, 1918, during the recent war. It will be observed from the table that between 20th July, 1914, and 20th December, 1920, there was a net fall in the aggregate market value of the 387 securities of £1,050,932,000, or 31·2 per cent., and that the different groups show widely different percentage variations. Only in American Railway Gold Bonds, Brewery Stocks, Insurance Shares, Shipping Shares, Telegraphs and Telephones, and miscellaneous Mining Shares, was there any appreciation. If, however, market values ruling in December, 1919 (when speculation was rampant), had been compared with those ruling in July, 1914, two of the other groups, namely, South African Mines and Commercial and Industrial Shares, would also have shown a marked appreciation. Between 15th December, 1919, and 20th December, 1920, the aggregate market value of the 387 representative securities decreased £314,707,000, largely on account of rapidly falling commodity prices, severe trade depression, and forced realizations of securities. All the groups contributed to this depreciation with the exception of American Railways. Commercial Industrial Shares fell 40·9 per cent., South African Mines 39·2 per cent., Iron, Coal and Steel Shares 33·7 per cent., and Shipping Shares 21·7 per cent.

At all times during the period under review, market values of different groups of stocks or shares naturally showed widely different percentage variations. The fixed interest-bearing stocks, particularly those in the gilt-edged group, were, in the main, most affected by the issue of large War Loans at increasing rates of interest, which absorbed practically all the funds which would otherwise have been available for investment in outstanding securities; and later, in 1920, by commercial difficulties causing forced realization of investments. War requirements for certain raw materials and finished goods, and shortage of transport, had a material and varying effect on the market values of some classes of shares. The speculative mania which set in after Peace was signed on 28th June, 1919, and continued into the early months of 1920, caused an entirely artificial rise in market values of the shares of a large number of companies. Textile shares, in particular, reached very inflated values during this period, to be later followed by rapid depreciation after the commencement of the fall in commodity prices in April, 1920. Market values and percentage variations of

same, of each group of securities at yearly intervals, taking values ruling on 20th July, 1914, as 100, are shown in tables on the next two pages, which originally appeared in the *Bankers' Magazine* for January, 1918, but with figures brought up to 17th December, 1917. It is an exceedingly interesting analysis of the movements in Stock Exchange securities since July, 1914, separation being made between fixed interest-bearing stocks and the ordinary shares and securities of industrial undertakings.

MARKET VALUES (000'S OMITTED) OF 387 REPRESENTATIVE SECURITIES (CLASSIFIED INTO GROUPS) AT 20TH JULY, 1914, AND AT 20TH DECEMBER, 1920.

Nominal Amount. (Par Value)	GROUP.	Market Values.		Increase or Decrease.	
		20th July, 1914.	20th Dec., 1920.	Actual.	Percentage
£		£	£	£	
862,786	9 British and Indian Funds . .	690,355	433,433	− 256,922	−37·2
52,250	7 Corporation (U.K.) Stocks . .	45,812	30,955	− 14,857	−32·4
82,850	11 Colonial Government Stocks .	79,288	64,754	− 14,534	−18·3
18,250	10 Corporation Stocks (Colonial and Foreign)	16,479	10,580	− 5,899	−35·8
881,950	31 Foreign Government Stocks .	746,677	364,411	− 382,266	−51·2
310,750	26 British Rail. Ordinary Stocks .	269,513	159,255	− 110,258	−40·9
133,500	11 British Rail. Debenture Stocks .	116,066	72,157	− 43,909	−37·8
149,500	13 British Rail. Preference Stocks .	128,168	76,835	− 51,333	−40·1
26,000	5 Indian Railway Stocks . . .	25,366	19,593	− 5,773	−22·8
88,440	9 Railways in British Possessions .	83,686	53,038	− 30,648	−35·6
346,000	17 American Railway Shares . .	346,085	316,341	− 29,744	− 8·5
178,000	16 American Railway Bonds (Gold) .	167,425	177,679	+ 10,254	+ 6·1
63,940	24 Foreign Railways	58,645	32,973	− 25,672	−43·8
29,338	14 British Bank Shares	182,650	162,152	− 20,498	−11·2
10,175	9 Colonial Bank Shares . . .	20,657	16,201	− 4,456	−21·6
15,420	13 Semi-Foreign Bank Shares . .	34,958	33,086	− 1,872	− 5·3
15,900	18 Brewery Stocks	20,040	22,005	+ 1,965	+ 9·8
9,000	4 Canals and Docks	5,040	5,041	+ 1	+ —
36,701	38 Commercial Industrial Shares .	81,662	54,488	− 27,174	−33·3
3,180	6 Electric Lighting and Power. .	4,021	2,745	− 1,276	−31·7
7,120	11 Financial, Land and Investment Shares	21,537	19,392	− 2,145	−10·0
28,635	5 Gas Stocks	33,290	20,039	− 13,251	−39·8
5,390	21 Insurance Shares	40,606	47,261	+ 6,655	+16·4
11,910	8 Iron, Coal, and Steel Shares . .	20,796	13,722	− 7,074	−34·0
7,200	7 Shipping Shares	14,546	21,319	+ 6,773	+46·6
8,885	4 Telegraphs and Telephones . .	10,542	10,938	+ 396	+ 3·8
4,970	7 Tramways and Omnibus . .	5,516	4,491	− 1,025	−18·6
2,715	4 Waterworks	2,854	2,028	− 826	−28·9
20,704	15 South African Mines, etc. . .	55,458	41,675	− 13,783	−24·8
9,703	6 Copper Mining Shares . . .	41,208	29,006	− 12,202	−29·6
3,424	8 Miscellaneous Mining Shares .	1,763	2,184	+ 421	+23·9
3,424,586	387 Representative Securities . .	3,370,709	2,319,777	−1,050,932	−31·2

In the table at the top of the next page there is shown the annual variation in the aggregate market value of the 387 representative securities since 18th December, 1913—

Aggregate Market Value of 387 Representative Securities (According to Valuations made by "The Bankers' Magazine")

Nominal Amount (Par value), £3,424,586,000

At	Market Value.	Annual Increase or Decrease.	
		Amount.	Percentage.
	£	£	
December 18, 1913 . . .	3,311,085,000	- 185,765,000	- 5·2
July, 20, 1914	3,370,709,000	—	—
,, 30, 1914[1]	3,182,717,000[2]	—	—
January 20, 1915[1] . . .	3,114,027,000	- 227,058,000	- 6·8
December 17, 1915 . . .	2,907,281,000	- 206,746,000	- 6·6
,, 18, 1916 . . .	2,758,349,000	- 148,932,000	- 5·1
,, 17, 1917 . . .	2,600,653,000	- 157,696,000	- 5·7
,, 17, 1918 . . .	2,801,089,000	+ 200,436,000	+ 7·7
,, 15, 1919 . . .	2,634,484,000	- 166,605,000	- 5·9
,, 20, 1920 . . .	2,319,777,000	- 314,707,000	- 11·9
July 18, 1921	2,345,346,000	—	—

387 REPRESENTATIVE SECURITIES CLASSIFIED INTO GROUPS.

Market Values in Million £'s

Stocks and Shares.	20th July 1914.	30th July, 1914.	20th Jan., 1915.	17th Dec., 1915.	18th Dec., 1916.	17th Dec. 1917.	17th Dec., 1918.	15th Dec., 1919.	20th Dec. 1920.
U.S. Railway Gold Bonds . .	167	166	166	171	170	150	154	163	178
Colonial Government . . .	79	79	78	75	68	68	71	68	65
U.K. Corporation	46	45	44	43	34	34	37	33	31
Colonial and Foreign Corporation	16	16	16	14	14	14	14	13	11
British and Indian Government .	690	646	632	580	526	520	561	492	433
British Railway Debenture . .	116	113	113	109	87	87	90	77	72
British Railway Preference . .	128	124	123	117	92	93	95	83	77
Foreign Government	747	699	673	571	531	530	553	449	364
Fixed Interest Stocks . . .	1,989	1,888	1,845	1,680	1,522	1,496	1,575	1,378	1,231
U.S. Railway Shares . . .	346	318	326	377	378	238	279	302	316
Colonial and Indian Railways .	109	102	100	99	88	83	91	85	73
British Railway Ordinary . .	270	256	255	216	204	195	211	193	159
Foreign Railways	59	55	50	46	41	39	43	43	33
[3] Railways	784	731	731	738	711	555	624	623	581
Shipping	15	14	14	16	20	21	24	27	21
Insurance	41	39	38	33	35	41	45	57	47
Brewery	20	20	16	12	12	18	21	24	22
Telegraph and Telephone . .	11	10	10	10	11	12	12	12	11
Fin., Land and Interest . . .	22	21	20	19	20	20	21	21	19
Bank	238	230	226	204	206	211	232	228	212
South African Mines, etc. . .	55	46	41	41	44	44	51	69	42
Copper Mining	41	35	36	37	48	49	49	43	29
Commercial and Industrial . .	82	77	70	60	68	72	82	92	55
Iron, Coal, and Steel . . .	21	21	21	18	22	23	24	21	14
Gas	33	32	27	22	22	21	23	21	20
Miscellaneous	19	19	19	17	17	17	18	18	16
	598	564	538	489	525	549	602	633	508
Fixed Interest Stocks . . .	1,989	1,888	1,845	1,680	1,522	1,496	1,575	1 378	1,231
Stocks mostly with Variable Dividends	1 382	1,295	1,269	1,227	1,236	1,104	1,226	1,256	1,089
387 Representative Securities .	3,371	3,183	3,114	2,907	2,758	2,600	2,801	2,634	2,320

[1] The London Stock Exchange closed after business hours on 30th July, 1914, and re-opened on 4th January, 1915.
[2] Record fall in ten days £187,992,000, or 5·6 per cent.
[3] Excluding British Railway Debenture and Preference Stocks and U.S. Railway Bonds (shown above in classification "Fixed Interest Stocks").

387 REPRESENTATIVE SECURITIES CLASSIFIED INTO GROUPS

PERCENTAGE OF MARKET VALUES ON 20TH JULY, 1914

STOCKS AND SHARES.	20th July, 1914.	30th July, 1914.	20th Jan., 1915.	17th Dec. 1915.	18th Dec., 1916.	17th Dec., 1917.	17th Dec., 1918.	15th Dec., 1919.	20th Dec., 1920.
U.S. Railway Gold Bonds . .	100	99	99	102	102	90	92	97	106
Colonial Government . . .	100	99	98	95	86	86	90	86	82
U.K. Corporation	100	98	96	94	74	74	80	73	68
Colonial and Foreign Corporations	100	98	97	85	82	82	85	81	64
British and Indian Government	100	94	92	84	76	75	81	71	63
British Railway Debenture . .	100	97	97	94	75	75	78	66	62
British Railway Preference . .	100	97	96	91	72	73	74	65	60
Foreign Government	100	94	90	77	71	71	74	60	49
Fixed Interest Stocks . . .	100	95	93	85	77	75	79	69	62
U.S. Railway Shares . . .	100	92	94	109	109	69	81	87	91
Colonial and Indian Railways .	100	93	92	91	81	76	83	78	67
British Railway Ordinary . .	100	95	94	80	76	72	78	71	59
Foreign Railways	100	94	85	79	70	66	74	74	56
[1]Railways	100	93	93	94	91	71	79	79	74
Shipping	100	93	99	109	135	147	166	188	147
Insurance	100	96	94	81	86	100	109	141	116
Brewery	100	99	80	61	62	88	102	117	110
Telegraph and Telephone . .	100	99	98	95	104	109	114	118	104
Fin., Land, and Investment .	100	97	93	89	93	95	98	98	90
Bank	100	97	95	86	87	89	98	96	89
South African Mines, etc. . .	100	82	74	74	79	80	92	124	75
Copper Mining	100	85	88	91	117	119	120	103	70
Commercial and Industrial . .	100	94	86	74	83	88	100	113	67
Iron, Coal, and Steel . . .	100	100	103	87	105	112	113	99	66
Gas	100	97	81	65	65	64	70	63	60
Miscellaneous	100	97	97	85	85	90	96	96	86
	100	94	90	82	88	92	101	106	85
Fixed Interest Stocks . . .	100	95	93	85	77	75	79	69	62
Stocks mostly with Variable Dividends	100	94	92	89	90	80	89	90	79
387 Representative Securities .	100	95	93	86	82	77	83	78	69

In connection with the above table, it has to be borne in mind that prices of securities during the year 1915 and the first half of 1916 were largely nominal, owing to the fixing and re-fixing during that period of official minima below which business was forbidden to be done. Protective minimum prices were not removed from all Stock Exchange securities until the beginning of July, 1916. Only from this month can it be said that prices truly represented market conditions. What prices would have been on 20th January, 1915 (sixteen days after the re-opening of the Stock Exchange),

[1] Excluding British Railway Debenture and Preference Stocks and U.S. Railway Bonds (shown above in classification "Fixed Interest Stocks").

under unrestricted market conditions it is not possible to form even a rough estimate. Nor is it possible to indicate the depreciation that would have taken place during August–December, of the year 1914, if the Stock Exchange had not been closed from 31st July of that year. The fall of £188,000,000 in market value during the ten days 21st–30th July clearly indicates that a veritable *debacle* in prices must have occurred if the Stock Exchange had remained open. During these ten days an avalanche of selling orders were received from the Continent.

After the artificial minimum prices were entirely removed in July, 1916, market values (with the exception of a small increase of £5,314,000 for the month ending 19th August) continued to fall monthly until February, 1917. On the 19th of that month, market values aggregated to £2,652,388,000. The next five months there took place some appreciation, £2,729,992,000 being reached on 20th July, 1917. Thereafter the tendency in values was downwards until 18th April, 1918, on which date the aggregate was £2,571,612,000. Rapid appreciation set in from May of 1918, when it became increasingly evident that Germany would shortly be suing for an armistice, the aggregate market value reaching £2,822,498,000 on 19th November, of that year. During 1919 and 1920, the general tendency was downwards, the lowest record £2,319,777,000, being reached on 20th December of the latter year. Prices during the early months of the former year were adversely affected by the dragging character of the Peace negotiations at Paris. The actual signing of Peace, on 28th June, 1919, produced practically no effect on the aggregate market values of securities, £2,727,906,000 being the amount on 18th June, and £2,731,227,000 on 18th July. During September, 1919–February, 1920, market values as a whole were fairly well maintained, but the fall in commodity prices from April, 1920, increasing trade depression, and commercial difficulties, led to considerable liquidation of securities later in the y ar. Some considerable appreciation in market values of outstanding securities during the six months September, 1919–March, 1920, would doubtless have taken place in the absence of the flood of new issues of every kind and description during this period.

To what extent, if any, there would have been depreciation in market values of securities if the war had not taken place, it is

obviously not possible to state. Prior to the war, depreciation had been almost continuous for many years, the net fall in the aggregate market value of the 387 representative securities for the seven years 21st January, 1907–20th January, 1914, being £453,699,000. For the seven years 20th January, 1914–19th January, 1921, covering the war period, the net fall was £1,053,285,000. These figures, however, it has to be borne in mind, do not show the relative severity of the depreciation over the two seven-year periods, for obviously the less the market price of a security, the greater the percentage fall represented by a point. For example, a fall of one point in a stock at a market price of 50 is equivalent to a fall of two points when the price is 100. The fall during the first seven-year period was equivalent to 11·8 per cent. of the aggregate market value at 21st January, 1907, namely, £3,843,177,000, but that during the second seven-year period to 31·1 per cent. of the aggregate market value at 20th January, 1914, namely, £3,389,478,000.

One good reason for thinking that there would have been no net depreciation in the aggregate market value of securities during the seven years 1914–1920, in fact, some appreciation, is explained in the next chapter, when referring to the interesting relationship between the yield of fixed interest-bearing securities and the cost of living. The various amounts that have been quoted as representing at different dates the aggregate market value of the 387 securities entering into the monthly valuation made by the *Bankers' Magazine* do not, of course, include War Loans and other issues since 1907, except that this Magazine made allowance for some £200,000,000 of Consols converted into the 4½ per cent. War Loan issued in 1915.

CHAPTER XIV

SECURITY PRICES: THEIR PROBABLE FUTURE COURSE

HAVING considered in the last chapter the course of security prices since 1914, and reviewed the various influences that gave rise to the great net depreciation in market values since that year, we will, in the present chapter, consider the probable course of high-class security prices during the next ten or fifteen years. With this object in view, it will be necessary to consider at length the basic factor determining market values of Government and other first-class stocks—namely, the cost of living. Reasons will be advanced for predicting a great appreciation during the next few years in all first-class securities bearing a fixed rate of interest, following the fall in commodity prices, and for stating that financial conditions will, sooner than most people expect, be favourable for the Government funding the greater part of the present large floating debt. It is to be noted, however, that these opinions are expressed subject to the absence during the period considered of any further great war, grave and prolonged social disturbances, or a series of bad harvests. All these three factors have a very material influence on the cost of living, and, consequently, as is fully explained in this chapter, on the course of first-class security values.

Reference will be made to the great fall in the market value of Consols during the Napoleonic Wars, and the rapid appreciation after these wars terminated, and at a time when the National Debt and taxation appeared to the community to be an intolerable burden. As financial conditions reflect economic conditions, a few remarks will also be made in relation to the effect of heavy taxation on the latter. A fall in yield of first-class stocks will prove an excellent index of improvement in economic conditions.

The law or relationship existing between the cost of living and investment values may be stated as follows—

> The course of the market prices of high-class fixed interest-bearing stocks is mainly indirectly determined by the cost of

living, a fall in the latter being usually accompanied or followed by a rise in the former, and conversely.

As the yield of fixed interest-bearing stocks at market prices obviously varies inversely to such prices, the above stated relationship may be alternately expressed in the following form—

> The yield of high-class fixed interest-bearing stocks at market prices is mainly indirectly determined by the cost of living, a fall in the latter being usually accompanied or followed by a fall in the former, and a rise in the latter by a rise in the former.

Owing to the interdependent connection existing between market values of different stocks bearing fixed rates of interest in the gilt-edged group, it will be sufficient, in order to prove the relationship existing between market values of high-class investments and the cost of living, simply to compare the course of the yield of Consols at market prices over a long period of years in the past with the course of commodity prices over the same period. For experience proves that if the price of Consols declines many points, other fixed interest-bearing stocks generally proportionally do likewise; similarly, if they rise, though irregular movements of a point or two do occur at times. This interdependence of market values is particularly true over a long period of years. For instance, comparing the mean of the highest and lowest prices for the year 1920 with that for the year 1907, Consols fell 43 per cent., Local Loans 3 per cent. stock and India 3½ per cent. stock each fell 44 per cent., and eleven British railway debenture stocks (taken as a whole), and thirteen British railway preference stocks (taken as a whole) each fell 45 per cent.

Inset there is shown a chart, the curves of which, based on averages for each year, represent the course of the yield of Consols at market prices and the course of wholesale commodity prices since the year 1820, the curve for the latter being based on the index number compiled by Mr. Sauerbeck for the period 1820–1912, and by *The Statist* (in continuation) since 1913. (For figures from which the curves are plotted, *see* table at end of chapter.) Wholesale commodity prices have necessarily to be taken as representative of the cost of living, for the purposes of this chapter, in the absence of an available and reliable index number based on a consumption standard. The difficulties in compiling such an index number

have always been considered insurmountable, for reasons explained in a previous chapter. Very little value can be attached to the index number of the cost of living published monthly in the *Labour Gazette*, for it only applies to working-class household expenditure; and even in this restricted capacity rests on a very rough basis. It will be observed from the chart that, generally speaking, the curve representing the course of the yield of Consols and the curve representing the course of commodity prices, generally either both rise together or fall together, a lead of any change in direction usually being given one year in advance by commodity prices. For the few periods or years in which there was not a sympathetic movement between the curves, an explanation can be given for such disagreement. The rise in the yield of Consols for the years 1830 and 1831 was due to a Revolution in France in 1830 and the introduction of the Reform Bill into the English Parliament in 1831, which caused considerable political disturbances, though it passed both Houses the following year. Both these important factors naturally severely depressed the price of Consols. The introduction of the Reform Bill caused many of the richer classes in this country to send their money to America and Denmark for investment. Another period of marked disagreement between the two curves was experienced during the three years 1871–1873. This lack of sympathetic movement was due to the fact that the Franco-German War, which commenced in July, 1870, and terminated in May, 1871, induced the wealthy classes on the Continent to send their money to England for safe investment. This abnormal inflow of foreign money seeking investment prevented the price of Consols falling (and, consequently, the yield rising) with the increase in the cost of living during this period. A minor divergence between the curves is shown for the year 1880, commodity prices rising this year instead of continuing to fall in sympathy with the gradual fall in the yield of Consols. During the previous year there was experienced the worst harvest of the century, and to this cause is to be attributed the temporary rise in commodity prices during the following year. Some slight divergence between the curves is also shown for the years 1889, 1903, 1904, 1905, following the reduction in the rate of interest on Consols from 3 to 2¾ per cent. from 5th April, 1889, and from 2¾ per cent. to 2½ per cent. from 5th April, 1903, arranged for in the Conversion

Scheme of 1888. Though these reductions had been previously largely discounted by the market in the price of Consols, yet some slight liquidation was left to be effected after 1889 and 1903, and the yield therefore continued to fall at a time when the commodity price curve would have warranted no change or a slight rise. All the causes that have been named to account for certain divergences between the courses of the two curves were, however, transient in effect, and simply partly hid, for short periods, the full influence being exerted on the yield or price of Consols by the course of commodity prices.

Another feature about the two curves that calls for some comment is the increasing width between them for the period 1881–1887. To explain the reason for this widening tendency, it will be necessary to consider briefly the course of the price of Consols during this period. The chart shows that during the period 1875–1896 there took place a prolonged fall in commodity prices (with an occasional upward temporary tendency), which fall was mainly due to the rapid development of the young food and raw material producing countries during the seventies and eighties of the last century. The degree of the fall was such that the price of Consols reached par by the year 1880, the highest and lowest prices for this year being 100¾ and 97⅜. Thereafter the price was retarded from rising much above par, and the yield proportionally falling, in sympathy with the continuing fall in commodity prices, through fear felt by the market of the Government exercising its standing option to redeem them at par on giving twelve months' notice to the holders. This fear later proved to be well-founded, for, in 1888, the Government offered holders of Consols,[1] and of the other two Three Per Cents. then outstanding, in exchange for their holdings a new stock bearing 2¾ per cent. interest from 5th April, 1889, until 5th April, 1903, then 2½ per cent. until 5th April, 1923, after which date the Government reserved the option to redeem the new stock at par. This conversion scheme of 1888, which involved stocks aggregating to £557,992,508 (Consolidated Three Per Cents., £322,681,032; Reduced Three Per Cents., £68,912,433; and New Three Per

[1] The word "Consols" originally came into market use through being applied, for the sake of brevity, to a consolidation in 1752 of several stocks, all bearing 3 per cent. interest. This rate remained unchanged until 5th April, 1889.

Cents., £166,399,043), proved a great success, very few holders electing to be paid off at par.

After the Conversion of 1888 had been effected, the two curves of the chart show close sympathetic fluctuations up to 1914.

The continuous fall that had taken place in the yield of high-class stocks during several years prior to 1888, which in reality was due to falling commodity prices, evidently led Mr. Goschen erroneously to believe that there would be no material reaction in the future under peace conditions, for in his speech to Parliament on 9th March, 1888, in support of the proposed conversion, he stated: "The investors in almost every kind of security had had to accept the fact that the rate of interest was falling, and must now be content with a smaller income from their capital than they had enjoyed before. They had had to bow to the inexorable logic of facts, and if now the Government proposed to reduce the income of the holders of Government securities, they were simply giving effect to natural causes which had operated on every other kind of security." The prolonged fall in commodity prices during the eighties of the last century was a good thing for the taxpayers of this country, in that it permitted of the successful conversion scheme of 1888, but it later proved very costly in the long run to permanent holders of Consols and subsequent purchasers, when commodity prices again commenced to rise after 1897.

Another influence that slightly affected the price of Consols during the eighties and nineties of the last century, though the effect was transient, was large purchases by the Government, on Savings Bank Account, of Consols and the other Three Per Cents. of the State then on the market. During 1881–1889 the Government increased its holdings of Consols and the other Three Per Cents. on Savings Bank Account by about £81,500,000, and during the period 1894–1898 its holdings of Consols for the same purpose by about £58,000,000.

Apart from the period 1881–1887, the chart also shows that no fixed difference has been maintained between the curves for any other long period, though an approximate fixed difference has occasionally continued for several years. If, however, commodity price index numbers were accurately representative of the cost of living, there would probably be found still greater correspondence between the two curves. Even if the yield of Consols had varied

proportionately to commodity prices, the chart would not have shown an exact fixed difference between the relative fluctuating curves, for one is plotted higher than the other from the base line.

The general sympathetic movement between the two curves representing commodity prices and the yield of Consols is obviously due to the fact that the less the cost of living the greater must necessarily be the margin available for investment, and, conversely, the greater the cost of living the less such margin. The correctness of this opinion is strongly supported by the fact that the chart discloses that changes in the direction of the curve representing the yield of Consols have usually been *preceded* by like changes in the direction of the curve representing commodity prices. It is evident that some little time must elapse before falling or rising wholesale commodity prices can affect the margin of income available for investment, for it is well known that retail prices do not change *immediately* after a change in wholesale prices, particularly if the latter be falling.

As a corollary to the above explained relationship between investment yield and the cost of living, it may be stated that investment yield is largely determined by the relative rate of production to consumption, for if production materially exceeds current consumption, commodity prices tend to fall. On the other hand, if consumption tends to exceed current production, commodity prices will usually rise.

Though the cost of living is undoubtedly the basic factor determining the course of first-class investment prices, yet changing trade conditions accelerate a fall or rise in such prices. During periods of trade activity, particularly in boom periods, when prices of commodities are rising and larger profits or dividends are, in consequence, being declared by industrial companies, there usually takes place a lesser demand for Government and other first-class stocks and an increased demand for industrial shares. In a period of falling prices, particularly if the fall be severe, when profits generally diminish, the converse takes place—an increased demand for first-class investments and a lesser demand for industrial shares. In this latter case financial embarrassment of some trading firms will first cause some liquidation of first-class investments, and, consequently, an initial fall in price, to be followed later by a

material rise. The public have short memories, and the above-stated cycle of transfer of savings seeking investment has taken place during and after every marked period of trade activity in the past. Rising commodity prices, trade activity, greater trading profits, rising prices of industrial shares, and rising interest rates ; falling commodity prices, trade depression, diminishing trading profits, often considerable losses, reconstructions, increased demand for Government and other first-class stocks, and falling interest rates. Such are, in brief, the events in sequence of the usual trade cycle. The extreme swings of the trade pendulum have never been so great as has been experienced during the past two years, the amplitude of which has been largely determined by unprecedented credit inflation.

EXTENT OF PROBABLE RISE IN FUTURE.—The chart proving beyond all doubt that a material rise in high-class investment prices will follow the present fall in commodity prices, and that the appreciation will be maintained in the absence of another material rise in commodity prices, due to such basic influences as a further great war, grave and prolonged social disturbances, or a series of bad harvests—in fact any influence that tends to make consumption again exceed production—the important point, particularly for those now in possession of liquid resources awaiting investment is : To what extent will there be a rise in investment prices in the future, and within what time ? Obviously, different people will give varying estimates to this interesting question. Mr. A. H. Gibson's opinion, subject to the absence of the above three named economic disturbances, is that within a period of five years the price of Consols will rise to 70 (yield £3 11s. 5d.), and thereafter the price will probably rise until about 77 (yield £3 5s.) is averaged over a long period of years, this figure being reached within a period of 10 to 15 years. He states there will be temporary falls, but the general tendency will be upwards. The rise will be accompanied by a sympathetic movement of other first-class stocks, except in so far as the latitude for movement above parity of any stock is restricted by a comparatively near year of optional redemption by the Government.

The reasons Mr. Gibson advances for thinking that the price of Consols will rise to the above-named figures within the specified periods are as follows—

1. The rapid fall that has already taken place in commodity prices since April of last year, and the reasons, stated in a previous chapter, entitled "Commodity Prices: Their Probable Future Course," for thinking that commodity prices five or seven years hence will not be materially higher than the pre-war level. The widely different gradients for the period 1915–1920 of the two curves of the chart, given as an inset, clearly indicate that the extent of the rise in commodity prices during such period was not warranted by the basic economic conditions of the United Kingdom. Part of the rise was undoubtedly due to transient psychological influences.

2. A study of the rise and fall in the annual average yield of Consols during and after the Napoleonic Wars. The prices suggested above entail no greater rate of recovery, judged from the yield standpoint, than was experienced after the Napoleonic Wars. These wars commenced in 1793, and finished in 1815. For the year 1791 the average yield was £3 12s. 6d., and for 1792 £3 10s. 9d. For the five years 1795–1799 it averaged £5 2s. 4d.—a maximum average of £5 15s. 5d. being reached for the year 1797. Complete recovery had been made by 1825, the yield for this year averaging £3 10s. 11d. For the five-year period 1825–1829, it averaged £3 11s. 2d., and for the succeeding five-years 1830-1834, £3 10s. 2d. For the ten-year periods 1835–1844, 1845–1854, 1855–1864, and 1865–1874, the average yield was remarkably steady, being £3 5s. 1d., £3 3s. 8d., £3 4s. 7d., and £3 5s. 3d. respectively. The rapid rise in the market prices of Government stocks after the Napoleonic Wars terminated permitted great conversion schemes to be successfully effected in 1822, 1824, 1830, and 1844, all of which involved a material reduction in the rate of interest. (For particulars, *see* later.) Before the recent war, for the three years 1911–1913, the price of Consols averaged 76⅝, and the yield £3 5s. 6d. The average yield for each of the years 1914,[1] 1915, 1916, 1917, 1918, 1919, 1920 was £3 6s. 9d., £3 16s. 4d., £4 6s. 2d., £4 11s. 5d., £4 7s. 11d., £4 12s. 6d., £5 4s. 7d. respectively. Consequently, if the rate of the rise and fall in yield during and after the Napoleonic Wars be any guide, the yield for the five years 1930–1934 should average

[1] For this year, average for first seven months, January–July. No market prices available for August–December. Stock Exchange closed 31st July, 1914–3rd January, 1915.

about £3 5s., corresponding to a price of 77, approximately the average for the three pre-war years 1911–1913. A very important point to bear in mind when considering the probability of the recovery in the price of Consols in the course of 10 or 15 years is that the productive capacity of the United Kingdom and other countries is now considerably greater than it was 100 years ago, after the termination of the Napoleonic Wars. For this reason, possibly the price may reach 77 before 1930–1934.

Some readers will doubtless think that Consols can never rise to 77, approximately the average for the three pre-war years 1911–1913, until there is a considerable reduction in taxation. This opinion cannot be supported by the course of the price after the termination of the Napoleonic Wars in 1815, for notwithstanding the great increase in taxation necessitated by these wars, which cost this country £831,000,000, and increased the National Debt from £237,400,000 (1792) to £846,000,000 (1816), the price of Consols had recovered to the pre-war level by 1825. Increased taxation has admittedly an indirect effect on market values of fixed interest-bearing securities if its tendency to increase the cost of living be not counteracted by factors operating in a reverse direction, such as inceased production in quantity. The redistribution of wealth and increased taxation occasioned by great wars are excellent incentives to increased production. There is later more liquid money available seeking investment or employment in trade at a time when large numbers of people have to work harder to maintain their pre-war standard of living, in the absence of increased output due to new inventions, greater application of machinery, or other material aids to production. This is probably the main reason why countries engaged in great wars in the past made rapid economic recovery after peace was declared. If they possess great potential productive capacity, complete economic recovery can only be a matter of time. The irreparable loss to the nations engaged in the recent war was the sacrifice of a great part of their virile manhood. The economic losses will probably be compensated for within a period of 10 years. At the present time this and other countries are going through a period of transition; they are, in truth, reaping the inflation harvest.

It has also to be remembered that part of the taxation paid by individual members of a community is received back by holders of

the Government debt within the community, in the form of interest on their holdings. Part of such interest will be available for investment in securities and in industry, and hence not only tend to raise the prices of existing securities but to lower the cost of living.

A great addition to taxation is admittedly a crushing burden to States whose productive power cannot expand, but in progressive manufacturing countries, such as Great Britain, production can be increased almost indefinitely by greater efficiency, and greater application and improvement of machinery. Increased taxation is like a task master. It compels people to work harder, to be more inventive, and to introduce improvements in manufacturing. It has been said that the great taxation following the Napoleonic Wars made England the greatest industrial and the wealthiest nation in the world, owing to necessity stimulating both industry and invention. The increased taxation necessitated by the recent war, heavy though it is, may yet be borne without being a heavy burden, if there be a compensating increase of production. If necessary, luxuries may be curtailed without affecting the real standard of living.

It is considerations such as the above that make economic laws a particularly interesting and valuable study. A superficial knowledge of the subject is a pitfall for the unwary, for deep down under social conditions basic economic laws or human tendencies are continuously and silently working, and trying to manifest themselves.

To the contention that the financial and economic effects of the recent war will be felt considerably longer than the disturbance occasioned by the Napoleonic Wars, because the increase in the National Debt during 1914-1919 was twelve times the increase during 1793-1815, it may be replied that the total national income at the commencement of the recent war was nine or ten times the amount at the commencement of the Napoleonic Wars. What the national income is at the present time (1921) it is impossible closely to estimate, but it is undoubtedly considerably greater than in 1913, owing to the great rise in commodity prices. For some years henceforth it will tend to diminish as prices, profits, and wages fall, following deflation.

Another important point to bear in mind, when considering the

matter of the rate of financial and economic recovery in the future (the two are interdependent), is that about £6,000,000,000 of the increase, namely, about £7,200,000,000, in the National Debt between 1st April, 1914, and 31st March, 1920, due to the recent war, simply represents increase in indebtedness within the community. Holders of the stocks and bonds represented by the National Debt, exclusive of the external debt of about £1,200,000,000, are creditors of themselves and of the other members of the State.

In a previous chapter it has been pointed out that the real measure of the burden of the National Debt to a community is not the nominal amount thereof but the total amount of interest the State has to pay thereon each year. As conversions involving a reduction in the rate of interest take place in the future, the real burden of the National Debt will be proportionally reduced.

Finally, in support of the opinion that there will be rapid economic recovery of this country, it cannot be said that the recent war made any great inroads into the total capital wealth of the United Kingdom. If this country had not had to make loans to her Allies and Dominions, there would have been no necessity for her to sell any great amount of her foreign investments, nor to raise considerable loans in the United States. Any payments in the future the United Kingdom receives on account of loans made to her Allies and reparations made by former enemy States will strengthen her economic position.

Looking at war expenditure from a national standpoint, it may be said that part of it goes in the form of profit to manufacturers and others engaged on war materials, and another part in wages to operatives, which is not, therefore, altogether lost to the nation; part of it is represented by ammunition and other Government stores which the community has produced by working more strenuously and by overtime at the factories and mills; and part of it is represented by ammunition and other Government stores, the energy to produce which has been diverted from productive industries. It is for this latter diverted energy, owing to war conditions, that the nation has really to pay the bill. In war time, energy which should go to the raising of the standard of living and the further accumulation of national wealth is expended and consumed on the battlefield.

The one uncertain factor to be borne in mind in relation to the future is the economic recovery of the impoverished smaller States, and whether they will be able to effect such recovery without grave social disturbances. The volume of the overseas trade of the United Kingdom is largely dependent on economic conditions ruling throughout the world.

EXTENT OF THE RISE SINCE 22ND DECEMBER, 1920.—The following table shows the rise that has already taken place in the price of Consols and certain War Loans since 22nd December last up to the time of writing—

	Issue Price. %	Price at 22nd Dec., 1920.	Price at 17th Aug., 1921.	Rise in Points.
Consols, $2\frac{1}{2}$% . . .	100	44	$48\frac{1}{8}$	$4\frac{1}{8}$
War Loan, $3\frac{1}{2}$% . .	95	$82\frac{7}{8}$	$86\frac{1}{4}$	$3\frac{3}{8}$
,, ,, $4\frac{1}{2}$% . .	100	$76\frac{3}{4}$	$81\frac{1}{4}$	$4\frac{1}{2}$
,, ,, 5% . .	100	$81\frac{7}{16}$	88	$6\frac{9}{16}$
,, ,, 4% [1] . .	95	$91\frac{1}{2}$	$96\frac{1}{2}$	5
Funding Loan, 4% . .	80	$65\frac{1}{4}$	$71\frac{1}{4}$	6
Victory Bonds, 4% . .	85	$70\frac{1}{2}$	$76\frac{1}{4}$	$5\frac{3}{4}$

[1] Income Tax Compounded.

In connection with the above table it has to be borne in mind that prices towards the end of 1920 were unduly depressed owing to home and Continental liquidation necessitated by financial pressure being felt by many trading concerns, the aftermath of inflation. A sustained and material rise in the prices of first-class investments is not to be expected until there is considerable reduction in retail prices, for, as has been explained, it is the course of the cost of living that finally determines the course of the yield of first-class fixed-interest bearing securities. Following the severe fall that has already taken place in wholesale commodity prices, adjustment in retail prices, based on current manufacturing and producing costs, cannot be delayed after this year. For the time being, financial and commercial liquidation, and the economic effects of the recent coal stoppage have also delayed recovery in first-class investment prices.

In the case of several of the loans issued during the recent war, there is every probability that their market prices will reach parity before, or soon after, the dates from which optional redemption

was reserved by the Government in the terms under which such loans were issued. They cannot rise many points above parity, on account of fear of the option of redemption being exercised by the Government. The 4½ per cent. War Loan of 1915 the Government has the option to redeem from 1st December, 1925; the 5 per cent. of 1917 from 1st June, 1929; and the 4 per cent. of 1917 (Income Tax compounded) from 15th October, 1929. When the optional dates of redemption arrive, if investment market conditions be favourable, the Government will exercise its option by offering holders, in exchange for old stock, a new stock bearing a lower rate of interest guaranteed for a certain number of years. Dissentients will be paid off at par. This was the procedure in former conversions, and the number of dissentients was usually small, as is shown by the particulars given below.

CONVERSIONS AFTER THE NAPOLEONIC WARS.—As in the case of the recent war, so during the Napoleonic Wars, it was necessary to issue large Government loans to finance the operations of hostilities. The Napoleonic Wars terminated in 1815, and, as soon as the market values of each of the loans issued during these wars tended to exceed parity, the Government took the opportunity to offer the holders, in exchange for their existing stocks, a new stock bearing a lower rate of interest guaranteed for a certain number of years. The exchange was usually effected by granting £100 of the new stock for every £100 nominal of the old stock to be converted, and dissentients were paid off at par. Particulars of the four main conversions effected during the first thirty years after the termination of the Napoleonic Wars are given below, being preceded by the particulars of the conversion scheme of 1749. This early conversion is of historical interest, and was the first of any magnitude to be effected.

An Act (23 Geo. II, c. 1) was passed in 1749 for the conversion of the Four Per Cents. which were standing above par into a new stock bearing 4 per cent. interest for one year, 3½ per cent. for the next seven years, and thereafter 3 per cent. The dissentients at first were fairly considerable, so they were given a second opportunity of considering the offer, but this time the 3½ per cent. interest was only guaranteed for five years. Holders of £38,806,496 out of a total £57,703,475 accepted the first offer, and the second offer brought in a further amount of £15,606,937. Dissentients holding

£3,290,042 stock were paid off at par. It is this converted stock of 1749 that formed the Reduced Threes eventually dealt with in 1888.

In 1822, seven years after the termination of the Napoleonic Wars, an Act (3 Geo. IV, c. 9) was passed providing for the conversion of the Five Per Cents. which stood at 108¾. The stock mainly consisted of "Navy Five Per Cents." Holders were invited to exchange every £100 of their stock for £105 of the new stock on which 4 per cent. interest was guaranteed for seven years. Holders of only £2,794,276 stock dissented and were paid off at par, the bulk, namely, £149,627,876 of the stock being converted into £157,109,217 New Four Per Cent. stock.

In 1824 an Act (5 Geo. IV, c. 11) was passed providing for the conversion of the Old Four Per Cents., which stood at 101¾ (*ex* div.). Holders were invited to exchange their stock for a Three-and-a-half Per Cent. stock irredeemable for five years. Out of a total amount of stock of £76,248,180, holders of £70,098,935 accepted, the dissentients, holding £6,149,245, being paid off at par. This dissentient stock was, however, actually converted into the Three-and-a-half Per Cent. stock and vested in the National Debt Commissioners.

In 1830 an Act (11 Geo. IV, c. 13) was passed providing for the conversion of the new Four Per Cents. which had been created in 1822 and which stock was standing at 102½ (*ex* div.). Holders might take £100 of a new Three-and-a-half Per Cent. stock guaranteed for 10 years or £70 of a new Five Per Cent. stock guaranteed for 42 years. Holders of £150,790,176 stock agreed to the conversion, and in the main taking in exchange the new Three-and-a-half Per Cents. The dissentients, who held £2,880,915 stock, were paid off at par.

In 1844 two Acts (7 & 8 Vict., c. 4, and 7 & 8 Vict., c. 5) were passed providing for the conversion of the various Three-and-a-half Per Cents., which stood at 101¾ (*ex* div.), including some old Three-and-a-half Per Cents. created in 1818. Holders were invited to take in exchange for their Three-and-a-half Per Cents. a new stock bearing 3¼ per cent. interest for 10 years, and 3 per cent. for a further 20 years. Practically the whole of the holders accepted the offer, for out of a total of £248,757,311 stock, the dissentients held only £103,352 stock. It is this converted stock that formed the "New Threes" dealt with in 1888.

Easier Financial Conditions in the Near Future.—A rise in the market values of first-class securities will be cumulative in hastening the restoration of sound financial conditions. If the present fall in commodity prices continues, investment market conditions should be favourable for the Government funding, within a period of two years, the greater part, if not the whole, of the floating debt. Another beneficial effect of rising market values of securities will be that the banks will effect sales of part of their War Loan investments when market prices approach to or reach original subscription prices, in order to accelerate deflation and restoration of sound financial conditions. Taking the banks collectively, a sale of part of their holdings of investments to the public effects, *per contra*, a corresponding reduction in their deposit liabilities, and therefore of the available purchasing power of the community.

During the early stages of a great war, the prices of Stock Exchange securities naturally fall more rapidly than any increase in commodity prices, for it takes time for war conditions to reflect themselves in a rise in commodity prices. The first impulse of traders at the outbreak of war is to reduce their stocks.

AVERAGE PRICE OF CONSOLS (THREE PER CENTS.)

For 1 year.[1]		For 5 years.	For 10 years.	For 20 years.	For 40 years.
1835	$91\frac{1}{16}$				
1836	$89\frac{7}{16}$				
1837	$90\frac{7}{8}$	$91\frac{3}{16}$			
1838	$92\frac{15}{16}$				
1839	$91\frac{9}{16}$		$92\frac{1}{4}$		
1840	$90\frac{1}{4}$				
1841	$89\frac{3}{8}$				
1842	92	$93\frac{1}{4}$			
1843	$95\frac{1}{4}$				
1844	$99\frac{3}{8}$				
1845	$98\frac{5}{8}$			$93\frac{1}{4}$	
1846	$95\frac{3}{4}$				
1847	$87\frac{1}{4}$	$91\frac{15}{16}$			
1848	$85\frac{1}{2}$				
1849	$92\frac{1}{2}$				
1850	$96\frac{1}{2}$		$94\frac{1}{4}$		
1851	$97\frac{1}{8}$				
1852	$99\frac{3}{8}$	$96\frac{1}{2}$			
1853	$97\frac{3}{4}$				
1854	$91\frac{7}{8}$				
1855	$90\frac{1}{2}$				$92\frac{7}{8}$, say, 93
1856	$93\frac{1}{8}$				yield
1857	$91\frac{7}{8}$	$93\frac{1}{2}$			£3 4s. 6d.
1858	$96\frac{7}{8}$				
1859	$95\frac{1}{8}$		$92\frac{7}{8}$		
1860	94				
1861	$91\frac{1}{2}$				
1862	93	$92\frac{1}{4}$			
1863	$92\frac{5}{8}$				
1864	$90\frac{1}{8}$				
1865	$89\frac{1}{2}$			$92\frac{7}{16}$	
1866	88				
1867	93	$91\frac{7}{16}$			
1868	$93\frac{7}{8}$				
1869	$92\frac{7}{8}$				
1870	$92\frac{1}{2}$		92		
1871	$92\frac{3}{4}$				
1872	$92\frac{1}{2}$	$92\frac{9}{16}$			
1873	$92\frac{1}{2}$				
1874	$92\frac{1}{2}$				

[1] Up to the year 1839 the mean of the highest and lowest prices. For the years 1840–1874, the middle prices at 1 o'clock on each day averaged for the year.

[The above table is particularly interesting as illustrating that, notwithstanding fairly considerable variations in annual averages, there was a general tendency over a period of 40 years for the price of Consols to fluctuate around 93, at which price a 3 per cent. stock yields £3 4s. 6d. By the Conversion Scheme of 1888, the interest on Consols was reduced to $2\frac{3}{4}$ per cent. from 5th April, 1889, and to $2\frac{1}{2}$ per cent. from 5th April, 1903. (Mr. A. H. Gibson thinks that *within* a period of 10 or 15 years the price of Consols will appreciate to about 77 (average for year), at which price the yield (with the present $2\frac{1}{2}$ per cent. interest rate) will be £3 5s., about the same as the average yield for the forty-year period 1835–1874.)]

COMMODITY PRICES AND THE YIELD OF CONSOLS SINCE 1791
(Five-year Averages for the Period 1795–1919)

Average for	Index Number of Commodity Prices.[1]	Yield of Consols at Market Price.[2]
		£ s. d.
1791	102	3 12 6
1792	106	3 10 9
1793	113	3 19 2
1794	112	4 8 9
1795-99	137	5 2 4
1800-04	145	4 14 9
1805-09	158	4 15 3
1810-14	144	4 16 0
1815-19	128	4 5 10
1820-24	106	3 16 9
1825-29	101	3 11 2
1830-34	91	3 10 2
1835-39	98	3 5 10
1840-44	92	3 4 4
1845-49	85	3 5 3
1850-54	85	3 2 2
1855-59	98	3 4 2
1860-64	101	3 5 1
1865-69	100	3 5 7
1870-74	103	3 4 10
1875-79	91	3 2 11
1880-84	83	2 19 11
1885-89	70	2 19 4
1890-94	68	2 16 4
1895-99	63	2 10 3
1900-04	71	2 17 0
1905-09	75	2 17 10
1910-14	82	3 5 0
1915-19	163	4 6 10
1914	83[3]	3 6 9[3]
1915	108	3 16 4[4]
1916	136	4 6 2
1917	175	4 11 5
1918	192	4 7 11
1919	206	4 12 6
1920	248	5 4 7

[1] For the period 1820–1912, the index number taken is that of Sauerbeck, and for 1913–1920 that of *The Statist* (in continuation of Sauerbeck). For the early period 1791–1819, the index number is that of Jevons × $\frac{9}{7}$, this multiplier representing the ratio between the index number of Sauerbeck and that of Jevons averaged for the period 1820–1829. For this and other reasons, the index numbers shown above for the period 1791–1819 may not be strictly comparable with those for later years compiled by Sauerbeck.

[2] Up to the year 1839, and for the year 1920, yield is based on the mean of the highest and lowest prices for each year. For the period 1840–1919, yield is based on the middle prices at 1 o'clock on each day averaged for the year.

[3] Average for first seven months. (Stock Exchange closed 31st July, 1914-3rd January, 1915.)

[4] The artificial minimum price of Consols was not removed until November.

The Average Price and Yield of Consols,[1] and the Index Number of Commodity Prices, for Each Year Since 1820

Year.	Average Price for the year.[2]	Causes Affecting Price, and therefore Yield.[3]		Yield at Average Price.			Index No. of Commodity Prices.[4]
				£	s.	d.	
1820	67 15/16	Commodity prices falling		4	8	3	112
1821	73 3/4			4	1	4	106
1822	79 3/16			3	15	8	101
1823	78 7/8	Commodity Prices rising.		3	16	1	103
1824	90 13/16		Commercial and Financial Crisis, 1825	3	6	1	106
1825	84 5/8			3	10	11	117
1826	79 3/16	Commodity Prices falling.		3	15	9	100
1827	83 1/8			3	12	2	97
1828	84 5/8		Revolution in France, 1830, caused uneasiness. Great social disturbances in U.K. also caused fall in price of Consols. Introduction of Reform Bill, 1831. Passed both Houses in 1832.	3	10	11	97
1829	89 15/16			3	6	8	93
1830	85 7/8			3	9	10	91
1831	79 13/16			3	15	3	92
1832	83 11/16			3	11	8	89
1833	87 3/4			3	8	4	91
1834	90 1/4			3	6	6	90
1835	91 1/16			3	5	11	92
1836	89 7/16	Rise in Commodity Prices		3	7	1	102
1837	90 7/8	Fall in Commodity Prices		3	6	0	94
1838	92 11/16	Commodity Prices rising		3	4	6	99
1839	91 7/16			3	5	7	103
1840	90 1/4			3	6	6	103
1841	89 3/8	Commodity Prices falling		3	7	2	100
1842	92			3	5	3	91
1843	95 1/4			3	3	0	83
1844	99 3/8	Commodity Prices rising.		3	0	5	84
1845	98 5/8			3	0	10	87
1846	95 3/4			3	2	8	89
1847	87 1/4		Commercial and Financial Crisis, 1847.	3	8	9	95
1848	85 1/2	Commodity Prices falling		3	10	2	78
1849	92 1/2			3	4	10	74
1850	96 1/2			3	2	2	77
1851	97 1/8			3	1	9	75
1852	99 3/8	Commodity Prices rising.		3	0	5	78
1853	97 3/4			3	1	5	95
1854	91 7/8		Crimean War, 1854-1855. Peace signed, 1856.	3	5	4	102
1855	90 1/2			3	6	4	101
1856	93 1/8		Commercial and Financial Crisis, 1857	3	4	5	101
1857	91 7/8			3	5	4	105
1858	96 7/8	Fall in Commodity Prices		3	1	11	91

[1] Consolidated Three Per Cents. from 1820 to 1888 (5th April), then Two-and-Three-Quarter Per Cents. until 1903 (5th April), and thereafter Two-and-a-Half Per Cents.

[2] Up to the year 1839, and for the year 1920, this average is the mean of the highest and lowest prices during the year. For the years 1840–1919, the average represents the middle prices at 1 o'clock on each day averaged for the year. The difference between the two methods of calculation of the average is usually only fractional, notwithstanding an extreme fluctuation of several points in the price during the year.

[3] A change in direction of commodity prices often precedes by a year a like change in direction of yield of Consols.

[4] For the period 1820-1912 the index number is that of Sauerbeck, and for 1913-1920 that of *The Statist* (in continuation of Sauerbeck).

THE AVERAGE PRICE AND YIELD OF CONSOLS,[1] AND THE INDEX NUMBER OF COMMODITY PRICES, FOR EACH YEAR SINCE 1820—*Continued*

Year.	Average Price for the year.[2]	Causes Affecting Price, and therefore Yield.[3]		Yield at Average Price. £	s.	d.	Index No. of Commodity Prices.[4]
1859	$95\frac{1}{8}$	Commodity Prices rising		3	3	1	94
1860	94			3	3	10	99
1861	$91\frac{1}{2}$			3	5	7	98
1862	93			3	4	6	101
1863	$92\frac{5}{8}$			3	4	9	103
1864	$90\frac{1}{8}$			3	6	7	105
1865	$89\frac{1}{2}$	Commodity Prices falling		3	7	1	101
1866	88		Banking Crisis, 1866.	3	8	2	102
1867	93			3	4	6	1[illegible]0
1868	$93\frac{7}{8}$			3	3	11	99
1869	$92\frac{7}{8}$		Franco-German War, 1870–1871	3	4	7	98
1870	$92\frac{1}{2}$			3	4	10	96
1871	$92\frac{3}{4}$	Notwithstanding Commodity Prices rising, price of Consols maintained. Franco-German War, 1870 1871, caused large inflow of money from Continent for safe investment		3	4	8	100
1872	$92\frac{1}{2}$			3	4	10	109
1873	$92\frac{1}{2}$			3	4	10	111
1874	$92\frac{1}{2}$	General tendency of Commodity Prices downwards owing mainly to rapid development of young food and raw material producing countries during seventies and eighties		3	4	10	102
1875	$93\frac{3}{4}$			3	4	0	96
1876	95			3	3	2	95
1877	$95\frac{3}{8}$			3	2	11	94
1878	$95\frac{3}{16}$			3	3	1	87
1879	$97\frac{1}{2}$			3	1	7	83
1880	$98\frac{3}{8}$			3	1	0	88
1881	100		Price of Consols prevented from rising much above parity through fear of conversion.	3	0	0	85
1882	$100\frac{1}{2}$			2	19	8	84
1883	$101\frac{3}{16}$			2	19	4	82
1884	101			2	19	5	76
1885	$99\frac{1}{3}$			3	0	5	72
1886	$100\frac{1}{4}$			2	19	6	69
1887	$101\frac{1}{4}$		Conversion Scheme, 1888. Rate of Interest reduced from 3% to $2\frac{3}{4}$% from 5th April, 1889.	2	18	11	68
1888	$99\frac{1}{2}$			3	0	4	70
1889	98			2	17	5	72
1890	$96\frac{1}{3}$			2	17	1	72
1891	$95\frac{3}{4}$			2	17	5	72
1892	$96\frac{1}{16}$			2	16	11	68
1893	$98\frac{1}{2}$			2	15	10	68
1894	$101\frac{1}{16}$			2	14	5	63
1895	$106\frac{1}{8}$			2	11	10	62
1896	$110\frac{3}{4}$			2	9	8	61
1897	$112\frac{13}{32}$			2	8	11	62

[1] Consolidated Three Per Cents. from 1820 to 1888 (5th April), then Two-and-Three-Quarter Per Cents. until 1903 (5th April), and thereafter Two-and-a-Half Per Cents.

[2] Up to the year 1839, and for the year 1920, this average is the mean of the highest and lowest prices during the year. For the years 1840–1919 the average represents the middle prices at 1 o'clock on each day averaged for the year. The difference between the two methods of calculation of the average is usually only fractional, notwithstanding an extreme fluctuation of several points in the price during the year.

[3] A change in direction of commodity prices often precedes by a year a like change in direction of yield of Consols.

[4] For the period 1820–1912 the index number is that of Sauerbeck, and for 1913–1920 that of *The Statist* (in continuation of Sauerbeck).

THE AVERAGE PRICE AND YIELD OF CONSOLS,[1] AND THE INDEX NUMBER OF COMMODITY PRICES, FOR EACH YEAR SINCE 1820—*Continued*

Year.	Average Price for the year.[2]	Causes Affecting Price, and therefore Yield.[3]		Yield at Average Price. £	s.	d.	Index No. of Commodity Prices.[4]
1898	110 15/16	Commodity Prices rising.	Market gradually discounting reduction in Rate of Interest from 2¾% to 2½%, to come into operation from 5th April, 1903	2	9	7	64
1899	106 7/8			2	11	6	68
1900	99 5/8			2	15	2	75
1901	94 1/4	S'th African War, 1899-1902		2	18	4	70
1902	94 3/8			2	18	3	69
1903	90 3/4			2	16	6	69
1904	88 1/4	Commodity Prices rising		2	16	8	70
1905	89 11/16			2	15	8	72
1906	88 5/16			2	16	7	77
1907	84 1/8		American Crisis, 1907	2	19	5	80
1908	86 1/16	Fall in Commodity Prices		2	18	1	73
1909	83 7/8	Commodity Prices rising		2	19	5	74
1910	81 1/16			3	1	8	78
1911	79 5/16			3	3	0	80
1912	76 1/8			3	5	8	85
1913	73 5/8			3	7	11	85
1914	74 7/8 [5]			3	6	9	83 [5]
1915	65 1/2	Rapid rise in Commodity Prices. Great European War, Aug., 1914-June, 1919. (Armistice, Nov., 1918.) Unprecedented inflation of credit.		3	16	4	108
1916	58			4	6	2	136
1917	54 11/16			4	11	5	175
1918	56 7/8			4	7	11	192
1919	54 1/16			4	12	6	206
1920	47 13/16			5	4	7	248

[1] Consolidated Three Per Cents. from 1820 to 1888 (5th April), then Two-and-Three-Quarter Per Cents. until 1903 (5th April), and thereafter Two-and-a-Half Per Cents.

[2] Up to the year 1839, and for the year 1920, this average is the mean of the highest and lowest prices during the year. For the years 1840-1919, the average represents the middle prices at 1 o'clock on each day averaged for the year. The difference between the two methods of calculation of the average is usually only fractional, notwithstanding an extreme fluctuation of several points in the price during the year.

[3] A change in direction of commodity prices often precedes by a year a like change in direction of yield of Consols.

[4] For the period 1820-1912 the index number is that of Sauerbeck, and for 1913-1920 that of *The Statist* (in continuation of Sauerbeck).

[5] Average for first seven months. Stock Exchange closed 31st July, 1914-3rd January, 1915.

CHAPTER XV

FOREIGN EXCHANGES

THE main movements of the exchanges since July, 1914, and the chief operating causes, are reviewed in the following pages at various stages broadly limited by four successive periods of time, namely—

1. Collapse of the exchanges at the end of July and commencement of August, 1914, when the European War appeared inevitable.
2. Gradual restoration of exchange machinery after the outbreak of war, from September to December, 1914.
3. The period 1915–1918, and covering the Armistice date, 11th November, 1918.
4. Since 1919, and covering the date of signing of Peace, 28th June, 1919.

It is to be noted, however, that no attempt is made to review in detail the innumerable influences that have affected exchange rates from day to day since 1914 (except at the outbreak of war). To do so would not only require the space of a separate volume, but an intimate knowledge of certain concealed Government operations. Moreover, such a detailed narrative, if possible, would probably divert the mind from clearly grasping the main economic forces that have determined the ultimate course of the various exchanges since 1914.

COLLAPSE OF EXCHANGES

The course of exchange rates for the period 23rd July–4th August, 1914, is shown by the table given on the next page. A study of these rates discloses the following points—

(*a*) The ultimatum presented by Austria to Serbia on 23rd July produced no discernible immediate effect on the exchanges, the reason for the steadiness in rates being that it was generally felt on that day that if war broke out it would be localized.

(*b*) During the next four days, 24th–27th July (the 26th was a Sunday) uneasiness was disclosed by some of the exchanges. Paris, which had at this time a balance in London in her favour, began to call in part of these funds, and the Paris rate fell 2½

The Collapse of the Exchanges at the Outbreak of War

(Latest Mean Rates on London)

		July, 1914.								August, 1914.		
	Parity.	23rd.[1]	24th.	25th.	27th.	28th.[2]	29th.	30th.	31st.	1st.[3]	3rd.[4]	4th.[5]
Paris, Cheques	25.22	25.18	25.17½	25.15	25.15½	25.12½	25.05	Nominal	Nominal	Nominal	Nominal	Nominal
Brussels, Cheques	25.22	25.30	25.30	25.30	25.29	25.29	25.29	Nominal	Nominal	Nominal	Nominal	Nominal
German, 8 Days	—	20.48	20.48	20.50½	20.50½	20.50	—	Nominal	Nominal	Nominal	Nominal	Nominal
German, Cheques	20.43	20.51¾	20.53	20.52⅞	20.53	20.53½	20.67½	Nominal	Nominal	Nominal	Nominal	Nominal
Vienna, Sight	24.02	24.22½	24.23½	24.24½	24.32½	24.37½	24.35	Nominal	Nominal	Nominal	Nominal	Nominal
Amsterdam, Cheques	12.107	12.14	12.14	12.14	12.14½	12.14¾	12.14½	Nominal	Nominal	Nominal	Nominal	Nominal
Switzerland	25.22	25.18½	25.19	25.18½	25.19	25.18½	25.19	Nominal	Nominal	Nominal	Nominal	Nominal
Italy, Sight	25.22	25.33½	25.33½	25.33	25.42½	26.00	Nom.	Nominal	Nominal	Nominal	Nominal	Nominal
Madrid, Sight	25.22	26.13	26.13	26.10	26.15	26.15	26.15	Nominal	Nominal	Nominal	Nominal	Nominal
Stockholm, Sight	18.159	18,25½	18.25½	18.26	18.27	18.28½	18.32½	Nominal	Nominal	Nominal	Nominal	Nominal
Lisbon, Sight	53¼d.	46¾d.	46¾d.	46⅝d.	46⅝d.	46⅛d.	46d.	Nominal	Nominal	Nominal	Nominal	Nominal
St. Petersburg, Sight	94.60	96.12½	96.32½	96.55	96.75	98.50N.	96.10N.	96.12N.	Nominal	Nominal	Nominal	Nominal
Montreal, Cable Transfers	4.86⅔	4.88 $\frac{11}{16}$	4. 88 $\frac{9}{16}$	4.88½	4.89 $\frac{9}{16}$	4.90¾	4.95N.	4.95N.	Nominal	Nominal	Nominal	Nominal
Montreal, Cheques[6]	—	4.89½	4.89⅛	4.89 $\frac{1}{16}$	4.90 $\frac{3}{16}$	4.93½	5N.	5 N.	Nominal	Nominal	Nominal	Nominal
Bombay, T.T.	1s. 4d.	1s. 3 $\frac{29}{32}$d.	1s. 3 $\frac{29}{32}$d.	1s. 3 $\frac{29}{32}$d.	1s. 3 $\frac{29}{32}$d.	1s. 3 $\frac{29}{32}$d.	1s. 3 $\frac{29}{32}$d.	1s. 3 $\frac{27}{32}$d.	1s. 3 $\frac{27}{32}$d.	1s. 3 $\frac{27}{32}$d.	1s. 3 $\frac{27}{32}$d.	1s. 3 $\frac{27}{32}$d.
Calcutta, T.T.	1s. 4d.	1s. 3 $\frac{31}{32}$d.	1s. 3 $\frac{31}{32}$d.	1s. 3 $\frac{31}{32}$d.	1s. 3 $\frac{31}{32}$d.	1s. 3 $\frac{29}{32}$d.	1s. 3 $\frac{29}{32}$d.	1s. 3⅞d.	1s. 3 $\frac{27}{32}$d.	1s. 3 $\frac{27}{32}$d.	1s. 3 $\frac{27}{32}$d.	1s. 3 $\frac{27}{32}$d.
Hong-Kong, T.T.	—	1s. 9 $\frac{11}{16}$d.	1s. 9¾d.	1s. 9⅝d.	1s. 9 $\frac{3}{16}$d.	1s. 9⅛d.	1s. 9⅛d.	1s. 9d.	1s. 8¾d.	1s. 8⅝d.	1s. 8⅝d.	1s. 8⅝d.
Shanghai, T.T.	—	2s. 4⅞d.	2s. 5d.	2s. 4¾d.	2s. 4¾d.	2s. 4⅛d.	2s. 4⅛d.	2s. 3⅞d.	2s. 3¾d.	2s. 3⅛d.	2s. 3⅛d.	2s. 3⅛d.
Singapore, T.T.	—	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.	2s. 3 $\frac{15}{16}$d.
Yokohama, T.T.	2s. 0 $\frac{29}{50}$d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.	2s. 0⅝d.
Alexandria, Sight	97½	97⅝	97⅝	97⅝	97½	97¼	97	97	97	97	97	97
Rio de Janeiro, 90 days' sight[7]	16d.	15 $\frac{15}{16}$d.	16d.	16d.	15⅞d.	15 $\frac{25}{32}$d.	15 $\frac{11}{16}$d.	15 $\frac{9}{32}$d.	15 $\frac{3}{32}$d.	14 $\frac{11}{16}$d.	14 $\frac{11}{16}$d.	14 $\frac{1}{16}$d.
Valparaiso, 90 days' Com.[7]	18d.	9 $\frac{21}{32}$d.	9 $\frac{21}{32}$d.	9 $\frac{21}{32}$d.	9 $\frac{9}{16}$d.	9 $\frac{7}{16}$d.	9⅛d.	9 $\frac{1}{16}$d.	8⅜d.	8⅜d.	8⅜d.	8⅜d.
Buenos Ayres, 90 days' Sight[7]	47.58d.	47 $\frac{11}{16}$d.	47 $\frac{11}{16}$d.	47 $\frac{11}{16}$d.	47 $\frac{23}{32}$d.	47¾d.	48d.	48d.	48d.	48d.	48d.	48d.
Monte Video, 90 days' Sight[7]	51d.	51 $\frac{3}{32}$d.	51 $\frac{3}{32}$d.	51 $\frac{3}{32}$d.	51⅛d.	51⅛d.	51⅛d.	51⅛d.	51⅛d.	51⅛d.	51⅛d.	51⅛d.
New York, Cable Transfers	4.86⅔	4·8885	4·8885	4·8925	4·9450	4.9435	4·9450N.	5.15N.	6.00N.	Nom.	Nom.	Nom.
New York Demand Bills	—	4·8805	4·8810	4·8815	4·9155	4·9135	4·9050N.	5.05N.	5.50N.	Nom.	Nom.	Nom.

[1] Austria presented ultimatum to Serbia.
[2] Austria declared war on Serbia.
[3] Germany declared war on Russia.
[4] Germany declared war on France.
[5] Great Britain declared war on Germany.
[6] London on Montreal.
[7] These rates are telegraphed the day preceding their receipt.

N. or Nom. in the above table represents Nominal

centimes. The German 8 days rate rose 2½ pfennige, and the Vienna and Italian rates 10 and 9 points. A small rise is also shown by the Madrid and Stockholm rates. The exchange of Russia, which country was pledged to support Serbia, rose 62½ points. The New York Cable transfer rate increased from 4·8885 to 4·9450. All the above-named rises were largely due to London calling in floating balances held abroad. The Belgian, Dutch, Swiss, South American, and silver exchanges, however, remained remarkably steady, and also during the next two days, 28th and 29th July, with the exception of the Valparaiso rate, which fell from 9.21/32d. on 25th July to 9⅛d. on 29th July, and the Rio de Janeiro rate from 16d. to 15.11/16d. between the same dates.

(*c*) War was declared by Austria on Serbia on 28th July. On this and the next day several of the European exchanges showed considerable movements, a prelude to the collapse a few days later. During 28th and 29th July, Paris continued to call in money from London, and this important rate during these two days fell 10½ points. The German cheque rate rose 14½ points, but the Vienna rate only a further 2½ points. The Italian rate became nominal. Stockholm rose 5½ points. The Montreal and New York rates were largely nominal.

All the leading foreign exchanges were affected during the last few days of July by the avalanche of securities being thrown on the markets and the closing of the various Stock Exchanges.

(*d*) From 30th July to 4th August there was a general collapse of the European and North American exchanges, all rates at first being nominal, and later no quotations being obtainable.

The New York Cable rate was marked up to 7.00 on 1st August, but it is doubtful if much business was done on this day above 5.00.

The reasons for the breakdown of the exchange machinery were five—

(i) A general call in by banks and financial houses of balances held abroad, whether at call or at short notice.

(ii) A general demand by traders abroad for sterling exchange to meet maturing liabilities in London, in particular their obligations to London Accepting Houses. There was not sufficient sterling exchange available to meet the great and sudden demand for same. The creation of finance bills had ceased.

(iii) The inevitable collapse of exchanges with enemy States,

which reacted immediately on the exchanges of other countries, owing to the interdependence of the various exchanges.

(iv) The closing of the Stock Exchanges.

(v) Restrictions placed on the export of gold by several countries.

In consequence of the above influences, arbitrage operations became impossible.

On 1st August, 1914, Germany declared war on Russia, and two days later on France. On 4th August, Great Britain declared war on Germany. During these successive declarations of war, the Eastern and South American exchanges showed little movement.

Restoration of Exchange Machinery

The paramount necessity of the restoration of the exchanges with all countries, except enemy States, for the resumption of international trading was early recognized by the British Government. With this object in view, various measures and proclamations were announced during August and September, for particulars of which see Chapters I and II. The Government undertook enormous liabilities in the form of guarantees, and the measures were successful in imparting momentum to the machinery of exchange. The gradual restoration of the various exchanges is clearly shown in the table given on the next page.

There was a rapid restoration of the exchanges from 10th September onwards, with one or two exceptions, rates by the end of the year being within reasonable proximity to the respective parities, though in several cases not within the customary gold points. The Lisbon exchange, however, re-opened and moved decidedly adverse to that centre, reaching 37¼d. on 31st December, as against 46d. on 29th July (before the exchange collapsed along with others). The Petrograd[1] exchange, which was in the neighbourhood of 96 before the collapse at the end of July, was re-opened at a considerably higher figure, and was 117 at the close of the year. This higher level was largely due to the extreme difficulty of Russia finding an outlet for her products, and the immense number of men she enrolled in her several armies. Very little alteration is shown in the Eastern exchanges, nor in the Buenos Ayres and Monte Video rates, but the Valparaiso exchange moved more

[1] St. Petersburg changed its name to Petrograd after the outbreak of war.

Restoration of the Exchanges After the Outbreak of War

(Latest Mean Rates on London)

1914

	10th Aug.	20th Aug.	31st Aug.	10th Sept.	19th Sept.	30th Sept.	30th Oct.	30th Nov.	31st Dec.	Parity.
Paris, Cheques	Nominal.	Nominal.	Nominal.	Nom.	25.35	25.20	25.17½	25.02½	25.05½	25.22
Amsterdam, Cheques				12.17½	12.15	12.06	12.03¾	12.02¼	11.99	12.107
Switzerland				Nom.	Nom.	Nom.	25.35	25.45	25.50	25.22
Italy, Sight				Nom.	26.85	26.80	26.12½	26.16	25.85	25.22
Madrid, Sight				Nom.	Nom.	25.65	26.35	25.85	25.35	25.22
Christiania, Sight				Nom.	Nom.	18.90	19.10	19.15	19.35	18.159
Lisbon, Sight				Nom.	Nom.	Nom.	Nom.	37½d.	37¼d.	53⅜d.
Petrograd, Sight				Nom.	Nom.	120	110	115½	117	94.60
Montreal, Cable Transfers	4.96¼	4.98½	4.95½	4.92½	4.93	4.92¼	4.89⅛	4.89¼	4.88⅛	4.86⅔
Montreal, Cheques	—	—	—	4.94½	Nom.	Nom.	4.91	4.90⅛	4.89¼	—
Bombay, T.T.	Nom.	1s. 3$\frac{27}{32}$d.N.	1s. 3$\frac{29}{32}$d.N.	1s. 3⅞d.N.	1s. 3⅞d.N.	Closed	Closed	1s. 3⅞d.	1s. 3⅞d.	1s. 4d.
Calcutta, T.T.	Nom.	1s. 3⅞d.N.	1s. 3⅞d.N.	1s. 3⅞d.N.	1s. 3$\frac{13}{16}$d.	Closed	Closed	1s. 3⅞d.	1s. 3$\frac{27}{32}$d.	1s. 4d.
Hong-Kong, T.T.	1s. 10$\frac{9}{16}$d.N	1s. 10d.N.	1s. 9d.N.	1s. 9⅝d.	1s. 9⅝d.	1s. 9⅝d.	1s. 8⅝d.	1s. 8½d.	1s. 9⅛d.	—
Shanghai, T.T.	2s. 6d.N.	2s. 5d.N.	2s. 4¼d.N.	2s. 4d.	2s. 3¾d.	2s. 3¼d.	2s. 2½d.	2s. 2⅛d.	2s. 2⅞d.	—
Singapore, T.T.	2s. 3$\frac{13}{16}$d.N	2s. 3$\frac{13}{16}$d.	2s. 3$\frac{13}{16}$d.	2s. 3$\frac{13}{16}$d.	2s. 3$\frac{13}{16}$d.	2s. 3$\frac{13}{16}$d.	2s. 4$\frac{1}{16}$d.	2s. 4$\frac{1}{16}$d.	2s. 4$\frac{1}{16}$d.	—
Yokohama, T.T.	2s. 0⅜d.	2s. 0⅜d.	2s. 0⅜d.	2s. 0⅜d.	2s. 0⅜d.	2s. 0⅜d.	2s. 0⅜d.	2s. 0⅜d.	2s. 0⅜d.	2s. 0$\frac{29}{50}$d.
Alexandria, Sight	97	96	96	96	96	96	97½	97½	97½	97½
Rio de Janeiro, 90 days' Sight	Closed	Nom.	14d.	Closed	12d.	11½d.	13¼d.	13¾d.	14$\frac{3}{32}$d.	16d.
Valparaiso, 90 days' Com.	8⅜d.	Nom.	8½d.N.	7¾d.N.	7½d.N.	7½d.N.	7$\frac{5}{16}$d.N.	7¼d.N.	7$\frac{1}{32}$d.N.	18d.
Buenos Ayres, 90 days' Sight	48d.	Nom.	49d.N.	48$\frac{9}{16}$d.N.	48$\frac{9}{16}$d.N.	48¾d.N.	46¾d.N.	48⅞d.N.	49d.N.	47.58d.
Monte Video, 90 days' Sight	51⅛d.	Nom.	52½d.N.	52½d.N.	52½d.N.	52d.N.	50½d.N.	51½d.N.	52½d.N.	51d.
New York, Cable Transfers	Nom.	5.03½	5.07	4.99½	4.96	4.99½	4.90¼	4.89¾	4.85½	4.86⅔
New York, Demand Bills	Nom.	Nom.	Nom.	Nom.	Nom.	Nom.	Nom.	4.90¼	4.86½	—

No rate for Brussels appears in the above table because it was occupied by the Germans during the War.
N. or Nom. in the above table represents Nominal.

adversely against that centre, and wide fluctuations took place in the Rio de Janeiro rate. The New York and Montreal Cables both receded to within the pre-war gold points (4·84 and 4·89)[1] by the end of the year, being 4·85½ and 4·88⅛ respectively on 31st December, 1914.

THE EXCHANGES DURING 1915–1918

The exchanges during this long war period present several interesting features, as will be observed from the table of rates, at certain intervals, given on the next page.

(*a*) Taking first the period covered by the 3½ years, 1915 (7th January)–1918 (28th June), the rates show that the French, Italian, Lisbon, and Petrograd exchanges moved in favour of London, but those of Holland, Spain, Switzerland, Scandinavia, and South America (with the exception of the Rio de Janeiro rate) moved adversely.

The French, Italian, and Russian currencies would have undoubtedly depreciated more than as shown by the table except for a series of large sterling credits having been periodically established on behalf of these countries by the British Government. The attempts by the British and French Governments, after the second year of war, to stabilize the Paris rate by arrangement of loans and credits, both in London and New York, and through the release of gold by the Bank of France, the table clearly proves to have been very successful. Possibly the attempts to stabilize the Russian exchange on London would have met with a similar success but for the uneasiness created by the after-effects of the Russian Revolution. Up to the end of 1915, exchange on London became increasingly unfavourable to Russia, owing to the stoppage of her export trade at a time when she urgently required increased quantities of foreign commodities. Her usual exports of grain, provisions, raw materials, etc., were considerably restricted by the closing of the Dardanelles and the cessation of trade with Germany and other countries via the Baltic ports and the railways over the West frontier. During 1916, though the Petrograd rate showed fairly wide fluctuations, yet it did not exhibit any general tendency to further depreciation. The abdication of the Czar

[1] Gold points are not fixed points, but vary slightly according to the current rate of interest and other variable costs.

The Course of the Exchanges During the War Years 1915–1918

(Latest Mean Rates on London)

	1915 7th Jan.	1915 2nd July.	1915 31st Dec.	1916 30th June.	1916 29th Dec.	1917[1] 29th June.	1917 28th Dec.	1918 28th June.	1918[2] 11th Nov.	1918 27th Dec.	Parity.
Paris, Cheques[3]	25.12	26.82½	27·73	28.13¾	27.80	27.39	27.21	27.15	25.83	25.97	25.22
Amsterdam, Cheques	12.01	11.93⅛	10.83	11.48½	11.68	11.54¾	10.95	9.37	11.46½	11.11½	12.107
Switzerland, Sight	25.50	25.75	24.90	25.22½	24.15	22.95	20.79	18.85	24.01½	22.65	25.22
Italy, Sight	26.00	29.15	31.45	30.35	32.65	34.30	39.68	43.85	30.31½	30.31½	25.22
Madrid, Sight	25.30	25.65	25.05	23.47	22.32½	20.33½	19.61	17.00	24.07½	23.72½	25.22
Christiania, Sight	19.35	18.17½	17.25	16.27½	16.05	16.14½	14.30	15.09½	17.55½	16.83½	18.159
Lisbon, Sight	37d.	36¾d.	34d.	35d.	31½d.	31¼d.	30½d.	30½d.	31d.	34d.	53¼d.
Petrograd, Sight	117	127½	159	155½	157	208¼	355	—	—	—	94.60
Montreal, Cable Transfers	4.87⅞	4.81¼	4.74½	4.78	4.76⅜	4.76⅝	4.78⅛	4.78	4.86½	4.83½	4.86⅔
Bombay, T.T.	1s. 3⅞d.	1s. 3$\frac{29}{32}$d.	1s. 4$\frac{1}{16}$d.	1s. 4$\frac{1}{16}$d.	1s. 4$\frac{3}{16}$d.	1s. 4$\frac{7}{32}$d.	1s. 4$\frac{31}{32}$d.	1s. 5$\frac{31}{32}$d.	1s. 6$\frac{1}{32}$d.	1s. 5$\frac{31}{32}$d.	1s. 4d.
Calcutta, T.T.	1s. 3⅞d.	1s. 3$\frac{29}{32}$d.	1s. 4$\frac{1}{16}$d.	1s. 4$\frac{3}{32}$d.	1s. 4$\frac{7}{32}$d.	1s. 4$\frac{7}{32}$d.	1s. 4$\frac{31}{32}$d.	1s. 5$\frac{31}{32}$d.	1s. 6$\frac{1}{32}$d.	1s. 5$\frac{31}{32}$d.	1s. 4d.
Hong-Kong, T.T.	1s. 9d.	1s. 9$\frac{5}{16}$d.	1s. 10⅞d.	2s. 1½d.	2s. 4¾d.	2s. 6⅜d.	3s. 0d.	3s. 3¼d.	3s. 2½d.	3s. 4½d.	—
Shanghai, T.T.	2s. 2$\frac{13}{16}$d.	2s. 3⅛d.	2s. 6⅛d.	2s. 11⅛d.	3s. 6½d.	3s. 9¾d.	4s. 4d.	4s. 8½d.	5s. 0d.	5s. 2d.	—
Singapore, Sight	2s. 4$\frac{1}{16}$d.	2s. 4d.	2s. 4$\frac{5}{32}$d.	2s. 4$\frac{5}{32}$d.	2s. 4$\frac{5}{32}$d.	2s. 4$\frac{5}{32}$d.	2s. 4$\frac{3}{16}$d.	2s. 2$\frac{17}{32}$d.	2s. 4d.	2s. 4¼d.	—
Yokohama, Sight	2s. 0⅜d.	2s. 0⅛d.	2s. 1⅛d.	2s. 2⅜d.	2s. 1$\frac{9}{16}$d.	2s. 1⅝d.	2s. 1⅝d.	2s. 4¼d.	2s. 3$\frac{7}{16}$d.	2s. 2¼d.	2s. 0$\frac{29}{32}$d.
Alexandria, Sight	97½	97½	97½	97⅝	97$\frac{5}{16}$	97⅜	97½	97½	97⅝	97½	97½
Rio de Janeiro, 90 days' Sight	14$\frac{3}{32}$d.	12¾d.	12⅛d.	Holiday	12⅛d.	13$\frac{15}{16}$d.	13$\frac{11}{16}$d.	12$\frac{13}{16}$d.	13$\frac{15}{16}$d.	13$\frac{11}{16}$d.	16d.
Valparaiso, 90 days' Sight	7$\frac{1}{32}$d.	7$\frac{11}{32}$d.	8$\frac{5}{16}$d.	9$\frac{3}{16}$d.	11$\frac{11}{16}$d.	12$\frac{11}{16}$d.	14$\frac{7}{16}$d.	17$\frac{1}{32}$d.	12⅜d.	9$\frac{31}{32}$d.	18d.
Buenos Ayres, T.T.	48⅞d.	48$\frac{7}{16}$d.	49⅛d.	48$\frac{15}{16}$d.	51d.	50¼d.	53d.	51½d.	51$\frac{5}{16}$d.	51¾d.	47.58d.
Monte Video, T.T.	52¾d.	52¼d.	53¾d.	53$\frac{3}{16}$d.	56¼d.	55d.	61¾d.	61½d.	59⅝d.	60d.	51d.
New York, Cable Transfers[4]	4.84⅜	4.77$\frac{3}{16}$	4.74½	4.76$\frac{7}{16}$	4.76$\frac{7}{16}$	4.76$\frac{7}{16}$	4.76$\frac{7}{16}$	4.76$\frac{7}{16}$	4.76$\frac{11}{16}$	4.76$\frac{9}{16}$	4.86⅔
New York, Sight	4.83⅞	4.76½	4.73$\frac{13}{16}$	4.75¼	4.75$\frac{9}{16}$	4.75⅜	4.75$\frac{3}{16}$	4.75$\frac{5}{16}$	4·75$\frac{9}{16}$	4.75$\frac{13}{16}$	—

[1] Revolution in Russia, 12th March, 1917

[2] The improvement in the exchanges took place largely during September and October, following victories by the Allies and requests for Peace by Austria and Bulgaria. Armistice made with Germany, 11th November, 1918.

[3] Throughout the war, until the middle of March, 1919, the French exchange was officially controlled from Paris.

[4] From January, 1916 to 20th March, 1919, the New York rate was maintained between 4·76 and 4·77, mainly in the neighbourhood of 4·76½, by the efforts of the Exchange Committee in London.

in the middle of March, 1917, had no immediate effect on the Russian exchange, but the after-effects of the Revolution—the state of internal disorders and anarchy existing in Russia from June onwards—caused rapidly increasing depreciation in the exchange on London, until, in 1918, quotations were unobtainable.

The exchanges of the main neutral countries naturally, during the war, depreciated against London, on account of Great Britain not being able to pay immediately for all imports from such countries, either by exports, gold, or other forms of settlement. Throughout the war, with the exception of during the year 1916, her adverse trade balance rapidly increased. War conditions not only caused considerable alteration in the customary channels and volume of international trade, but threw a heavy strain on the productive power and financial resources of Great Britain. She had not only to provide for her own armies, but also for a considerable part of the requirements of her Allies. London credits opened on behalf of the latter were partly the reason for adverse neutral exchanges. To what extent adverse movements in some of the neutral exchanges on London during the war were due to increase in the indebtedness of Great Britain or of her Allies to those countries, it is not possible to state with any degree of certainty. But with reference to such indebtedness the following statement was made by the Chancellor of the Exchequer in the House of Commons on 24th July, 1917: "From the beginning this country has borne the whole of the expense of supplies to all the Allied countries which were produced in the United Kingdom. Up to the time of the entry of America into the war, we also bore in the case of some of the Allies the whole of the expenditure outside their own country, and in the case of all of them some portion of the expenditure out of their own country."

(At the outbreak of war, several of the neutral exchanges moved temporarily in favour of London, on account of the general calling in of money at call or at short notice, previously lent to foreign countries, by British banks and financial houses, and the withdrawal of customary credit facilities.)

The exchange with Holland was, during the war, to a very material extent controlled by England.

Part of the further depreciation in several of the neutral exchanges during 1917 is also to be accounted for by the tightening of the blockade around the Central Powers. The closer blockade led to

a considerable reduction in the volume of goods imported by the surrounding neutral countries, especially in the volume of goods imported from America, and is therefore bound to have exercised some influence on neutral exchange rates on London.

Another interesting reason for the exchanges of the Scandinavian countries moving more and more adversely to London during the war was that settlement with such countries had necessarily to be made or offered largely in the form of gold, on account of the small amount of Scandinavian securities held by the Allies. An unexpected situation arose in consequence. Owing to surfeit of gold, and also to their desire to obtain certain commodities from the Allies, the Scandinavian countries chose repeatedly to permit exchange rates to fall rather than take more gold from the Allies. Early in February, 1916, the Swedish Parliament passed a law releasing the National Bank from an obligation to buy gold. It was contended at the time that, owing to great increases in exports to Great Britain, Sweden was in danger of being flooded with gold, and inflation was feared as a consequence. By April, Norway and Denmark had adopted similar measures, and it appears that the respective State Bank notes were then at a premium as compared with gold. Attempts by the Allies to stabilize the Scandinavian exchanges were also rendered impossible on account of the large sums that were continually accruing during the war in favour of Scandinavian shipowners, who carried for the Allies enormous freights at very high rates.

A sentimental influence that tended to cause depreciation in the currencies of belligerent countries during the war was the alarm felt by neutral nations at the growing war expenditure of the belligerents.

With reference to the great appreciation in Spanish currency during the period under review, it has to be borne in mind that of all neutral countries in Europe, Spain suffered the least amount of interference in its foreign trade during the war. Not only was its geographical position a very advantageous one, inasmuch as it was remote from the war zone, but it was able to carry on a large and highly profitable trade with France and England without the risks of a long sea transit. As these countries were in great need of Spanish products, both raw materials and finished goods, regardless of cost, the balance of trade was inevitably greatly in favour

of Spain, which country in consequence became the chief creditor nation in Europe during the war. In an attempt to minimize the depreciation in sterling, gold was sent to Spain from America, indirectly provided by England.

The general tendency of the New York exchange during 1915 and the greater part of 1916 was downwards, though there were somewhat violent oscillations. At the commencement of 1915 the cable rate was within the customary pre-war gold points (4.84 and 4.89), being 4.85¾ on 1st January. By 17th February, 4.80 was touched. Between that date and 14th June the extreme fluctuations were 4.82¼ and 4.78½, and between 15th June and 6th August, 4.77⅞ and 4.76¾. At the end of February, March, April, May, June, and July, the rates were respectively 4.80½, 4.80¼, 4.79½, 4.78⅞, 4.76¾, and 4.76⅝. During August there took place an exceptionally heavy fall in the rate, 4.59½ being reached at the end of the month. On 1st September there was a severe fall to 4.47, which, however, proved to be only temporary, the rate responding to 4.64 the next day and to 4.70 on 3rd September. At the end of the month the rate was 4.72. The general tendency during October was downwards, 4.62½ being reached on 27th of that month. Thereafter, the tendency was upwards (until the stabilization of the exchange, *see* below), $4.74\frac{3}{16}$ being recorded at the end of December. To some extent, the New York exchange was supported during the second half of 1915 by the Bank of England, acting on instructions from the Treasury, purchasing American Dollar Securities in London and transmitting them to New York for sale. From 6th January, 1916, to 20th March, 1919,[1] the New York rate was maintained between 4.76 and 4.77, mainly in the neighbourhood of 4.76½, by the efforts of the Exchange Committee in London.[2] The rate was successfully stabilized by the export of gold to the United States, the repatriation of American securities held by the Allies, the arranging of loans in the United States with American and other securities pledged as collateral, and from 25th April, 1917,[3] by direct loans from the American Government to the Allies. The stabilizing of the New York rate for a long period was very creditable to the Exchange Committee in

[1] Date from which control was removed.

[2] *See* Report of American Dollar Securities Committee reviewed in Chapter VI, Section, " Borrowings, Abroad."

[3] America entered the war on the side of the Allies on 5th April, 1917.

London, particularly in view of the United States of America being the country from which the Allies obtained during the war the major part of their external supplies.

In the case of the Montreal cable rate, the table shows that a severe fall took place during 1915, 4.74½ being reached at the end of the year. Thereafter, at six months intervals up to 28th June, 1918, the rate was fairly stable at 4.76–4.78, in rough sympathy with the stabilized New York rate.

The China exchanges during 1915–1918 moved adversely to London, largely as the result of the keen demand for silver from practically all countries. As a consequence of considerably increased demand for coinage purposes, silver rapidly rose in price. With every upward movement in silver there was an increase in the value of the Hong-Kong dollar and the Shanghai tael. Owing to the fixed sterling price of the rupee (15 Rs. to £1), the Indian exchanges were prevented from showing a sympathetic movement with the China exchanges. As a natural result, rupees became scarce, and the exchange banks had practically their operations confined to the financing of Indian exports of national importance. During the war, the balance of trade was heavily in favour of India.

(*b*) Reverting again to the last table, it will be observed that between 28th June and 11th November, 1918 (the date on which the Armistice was made with Germany), there was a considerable improvement (in the sense of movements towards parities) in the European exchanges and in the Montreal rate. (The New York rate at this period was pegged at about 4.76½, as already explained.) This improvement, it has to be noted, took place largely during September and October, following victories by the Allies and requests for peace by Austria and Bulgaria. The South American rates, however, showed little change, with the exception that Chilean currency depreciated heavily. During several periods of the war certain exchange rates fluctuated to some extent with the varying phases of hostilities, on account of sentimental reasons.

(*c*) After the date of the Armistice, 11th November, the table shows that the neutral exchanges, by the end of the year, re-acted against London.

The Exchanges Since 1919

The course of the exchanges since the commencement of 1919,

which at certain intervals is shown on the following page, may, for the purpose of review, be conveniently divided into three periods, namely: (*a*) The first six months of the year 1919, during which protracted peace negotiations were taking place at Versailles; (*b*) the last six months of 1919 and the first three months of 1920, during which there was a very rapid increase in wholesale commodity prices; and (*c*) the period since 1st April, 1920, during which in this and other countries, with a few exceptions, there has taken place a great re-action in prices, the fall being accompanied or followed by a general trade slump and growing unemployment, the usual accompaniments of a period of rapidly falling prices. Below there are given reasons for the main movements in the exchanges during the above-named periods.

(*a*) Peace was signed on 28th June, 1919. During the preceding six months, while peace negotiations were taking place, it will be observed from the table that—

The currencies of France, Belgium, and Italy depreciated, partly on account of increasing imports from this country and reduced amounts of new loans from the British Government. In Paris, official control of the exchange rate, through sales of sterling, was removed about the middle of March.

The exchanges of Scandinavia, Denmark, Holland, and Switzerland moved upwards towards parity (the Christiania and Copenhagen rates even rose above parity), also largely on account of increasing exports to such countries, in particular of textiles. Neutral countries bought large stocks of high-priced finished goods, partly with the object of re-sale to Germany immediately after the signing of peace.

A fall of comparatively small degree is shown by the Madrid rate, but the Lisbon quotation moved materially in favour of London, and further away from parity.

Government control was removed from the American exchange on 20th March, and thereafter there took place a rapid fall in the New York rate, which by 30th June reached 4.59½. The Montreal rate fell in sympathy, though not to the same degree.

Little net movement was shown by the China exchanges during the first six months of 1919, largely because the United States and British Governments fixed a maximum price to silver of about 4s. 2d. per ounce for the period August, 1918–May, 1919.

THE COURSE OF THE EXCHANGES SINCE THE COMMENCEMENT OF 1919

(Latest mean rates on London)

	1919	1919	1919[1]	1919	1920	1920	1920	1920	1920	1921	Parity.
	3rd Jan.	28th Mar.	27th June.	3rd Oct.	2nd Jan.	31st Mar.	2nd July.	1st Oct.	31st Dec.	1st Apr.	
Paris,[2] T.T.	25.97½	27.65	29.71½	35.35½	40.92½	57.75	47.22½	51.87½	59.74½	56.09½	25.22
Brussels, T.T.	27.60	29.35	30.87½	35.45	40.42½	54.07½	44.67½	49.32½	56.89½	53.75½	25.22
Berlin,[3] T.T.	—	—	—	100¼	187½	279	149¼	213½	258	245½	20.43
Vienna, T.T.	—	—	—	—	—	810	570	815	1500	1520	24.02
Amsterdam, T.T.	11.15	11.46½	11.82	11.15¼	10.07	10.42½	11.18	11.18	11.27	11.36	12.107
Switzerland, T.T.	22.95⅛	22.92½	24.87½	23.46	21.16½	22.02½	21.88½	21.70	23.17½	22.59½	25.22
Italy, T.T.	30.31¼	34.47½	36.87½	41.25	50.00	80.62½	65.62½	83.60	101.87½	95.87½	25.22
Madrid, T.T.	23.67⅛	22.82½	23.22½	22.02	19.72½	22.26½	24.17½	23.71½	26.46½	28.06½	25.22
Christiania, T.T.	16.85	17.92	18.32	18.17	18.60	22.00	23.77½	24.60	23.15½	24.42½	18.159
Stockholm, T.T.	16.29⅛	17.26½	17.79	17.13½	17.50	18.01	17.91½	17.52	17.70	16.81½	18.159
Copenhagen T.T.	17.67⅛	18.46	19.32	19.42	19.66½	21.28½	23.97½	24.77½	23.17½	21.42½	18.159
Lisbon, T.T.	34d.	33⅞d.	30⅛d.	26¼d.	19½d.	14⅞d.	11⅛d.	11⅛d.	6¼d.	5¼d.	53¼d.
Montreal Cable	4.84⅝	4.78½	4.73⅝	4.37½	4.11½	4.20¾	4.50½	3.84½	4.09½	4.42½	4.86⅝
Bombay,[4] T.T.	1s. 6 1/32d.	1s. 6 1/32d.	1s. 8 1/32d.	2s. 0¾d.	2s. 4¼d.	2s. 4 1/16d.	1s. 9 11/16d.	1s. 9 7/16d.	1s. 5¾d.	1s. 3¼d.	10 Rs. to
Calcutta,[4] T.T.	1s. 6 1/32d.	1s. 6 1/32d.	1s. 8 1/32d.	2s. 0¾d.	2s. 4¼d.	2s. 4 1/16d.	1s. 9 11/16d.	1s. 9 7/16d.	1s. 5¾d.	1s. 3¼d.	gold sov.
Hong-Kong, T.T.	3s. 4¼d.	3s. 2¾d.	3s. 6¾d.	4s. 2½d.	4s. 10½d.	4s. 11d.	3s. 8d.	4s. 3½d.	3s. 2 5/16d.	2s. 5d.	—
Shanghai, T.T.	5s. 2d.	4s. 8⅛d.	5s. 4d.	6s. 4½d.	7s. 8¾d.	7s. 7d.	5s. 1¾d.	5s. 11¾d.	4s. 1⅛d.	3s. 1¾d.	—
Singapore, T.T.	2s. 4 3/16d.	2s. 4d.	2s. 4 3/16d.	2s. 4¼d.	2s. 4⅜d.	2s. 3⅞d.	2s. 3⅞d.	2s. 3⅞d.	2s. 3 13/16d.	2s. 3⅞d.	—
Yokohama, T.T.	2s. 1⅞d.	2s. 2d.	2s. 2 9/16d.	2s. 4 15/16d.	2s. 8d.	2s. 4⅜d.	2s. 7½d.	2s. 11⅛d.	2s. 8⅛d.	2s. 5 7/16d.	2s. 0 29/50d.
Alexandria, Sight	97½	97½	97½	97½	97½	97 7/16	97½	97½	97½	97½	97½
Rio de Janeiro, 90 days' Sight	13⅛d.	13 13/32d.	14 11/16d.	14 11/16d.	17 11/16d.	16⅞d.	14⅛d.	12⅛d.	9 13/16d.	9 1/16d.	16d.
Valparaiso, 90 days' Sight	10 25/32d.	10 5/16d.	11d.	11 7/16d.	12 19/32d.	13 3/16d.	12 11/32d.	11 1/16d.	9 11/32d.	8½d.	18d.
Buenos Ayres, T.T.	51¾d.	51⅛d.	50⅞d.	54⅜d.	62⅝d.	61⅜d.	57⅜d.	57¼d.	51⅛d.	46¾d.	47.58d.
Monte Video, T.T.	61¼d.	62d.	54¾d.	57⅝d.	65¾d.	60¾d.	59¼d.	58d.	50d.	44d.	51d.
New York,[5] Cable	4.76⅛	4.68½	4.59⅞	4.23½	3.78½	3.87	3.96	3.48¾	3.54½	3.92½	4.86⅝

1 Peace signed with Germany on 28th June, 1919.

2 Official control was removed in France from the Paris exchange about the middle of March, 1919.

3 In the month of August, 1919, a tentative rate for Berlin was fixed at about 80–90, but market conditions soon caused a rapid rise in this rate.

4 Since 2nd February, 1920, the exchange value of the rupee has been fixed at 10 rupees to one *sovereign*. Prior to this date the exchange value was 15 rupees to one pound sterling.

5 Government control was removed from the American exchange on 20th March, 1919.

The South American exchanges all moved towards their respective parities, the Rio de Janeiro and Valparaiso rates moving adversely and the Buenos Ayres and Monte Video rates more favourable to London.

(*b*) During the nine months ending 31st March, 1920, following the signing of peace on 28th June, 1919, considerable movements took place in several of the exchanges. The rates ruling at the dates taken in the table do not show the full extent of the extreme movements experienced during this period. The greatest changes, it will be observed, took place in certain Continental rates. Such movements were, to a large extent, due to inflation of credit and currency and high-priced imports from the United Kingdom.

The currencies of France, Belgium, and Italy all materially depreciated. The French exchange reflected the full effects of decontrol in March, 1919. The Paris end of month rates were as follows: 1919, July, 31.60; August, 33.99½; September, 35.55; October, 36.75; November, 39.37½; December, 41.09½. 1920, January, 46.45; February, 48.30½; March, 57.67½. Progressive depreciation in French and Belgian francs in the absence of control was to be expected, in view of many industrial areas in Northern France and Belgium having been devastated by war conditions. Until eventual restoration of such areas, or compensation made in production in other parts, high-priced importations from the United Kingdom and other countries were to a large extent unavoidable.

The Italian exchange reflected to a considerable extent internal industrial disturbances. Since the war terminated, Italy has experienced an almost unending series of strikes, large and small, in all branches of industry, and in the public services. Exhaustion, disorganization, and impoverishment were disasters which the war brought on almost all the combatant nations, but on Italy in a special degree because she was at the outset less well equipped to bear the strain. But the chief obstacle to her economic rehabilitation, and therefore to the recovery of her exchange, has been labour unrest.

In the month of August, 1919, a tentative rate for Berlin was fixed at about 80–90, but market conditions soon caused a rapid rise in this rate. The depreciation in the mark was very largely due to excessive inflation in Germany. Internal political disturbances and her attitude to the indemnity question reflected

themselves to some degree in her exchange. Austrian currency also showed rapid depreciation, partly due to the bad internal economic condition of Austria, but largely to inflation.

The Dutch, Swiss, and Spanish rates receded, but those of Scandinavia and Denmark moved in favour of London. Rapid depreciation took place in Portuguese currency, largely owing to grave political disturbances in Portugal.

The New York and Montreal rates continued their tendency to move more adversely to London, the greater fall taking place in the former. The New York end of month cable rates were as follows: 1919, July, 4.35⅞; August, 4.19¾; September, 4.19¾; October, 4.16⅝; November, 4.01; December, 3.75½. 1920, January, 3.50½; February, 3.39¾; March, 3.86¾.

As a consequence of the removal, in May, 1919, of the maximum price for silver, the China rates moved in sympathy with a rapid increase in the market price of that metal. The record price of 89½d. per ounce standard was reached on 11th February, 1920.

The rupee rose about 8d. in price, partly owing to the rise in the price of silver and partly due to the exchange value of the rupee being changed on 2nd February, 1920, from 15 Rs. to £1 sterling to 10 Rs. to one sovereign.

In the case of the South American exchanges, all four shown in the table moved adversely to London, but the Valparaiso rate was still well under parity at 31st March, 1920.

(*c*) The last period to be briefly reviewed is that for the year ending 1st April, 1921, and covering a period of rapidly falling commodity prices. How far some of the Continental exchanges were affected by varying rates of fall in commodity prices in different countries, and how far by further inflation, it is not possible to form even an approximate estimate.

A slight improvement towards parity was shown in the Paris and Brussels rates during the twelve months, though it is to be noted that fairly considerable fluctuations took place. The Brussels rate tended to move in sympathy with the Paris rate at a difference of 2 to 3 francs under the latter. The Paris end of month rates were as follows: 1920, April, 63.85; May, 50.15; June, 48.12½; July, 48.65; August, 51.45; September, 52.27½; October, 54.32½; November, 57.65; December, 59.75. 1921, January, 54.30; February, 54.37½; March. 55.87½.

The Berlin rate fluctuated widely, and Austrian currency rapidly depreciated. In both Germany and Austria there was further considerable monetary inflation, but in the former country some compensation for such increase was afforded by greater production. It appears exceedingly doubtful whether Germany will eventually be able to deflate her currency without experiencing grave industrial troubles. The process will be watched with great interest by all economists.

Movements in favour of London were shown by the Dutch, Danish, Swiss, and Scandinavian exchanges, with the exception of the Stockholm rate, which moved adversely.

Further depreciation took place in Italian and Portuguese currencies, particularly in the case of the latter. The Madrid rate also moved considerably in favour of London, and to above parity.

Some net improvement was shown by the Montreal and New York rates, the greater rise taking place in the former rate. The extreme fluctuations during the twelve months were unexpectedly wide. End of month New York rates were as follows: 1920, April, 3.84⅜; May, 3.89; June, 3.95½; July, 3.71¼; August, 3.55¼; September, 3.46¾; October, 3.45½; November, 3.49; December, 3.54¼. 1921, January, 3.86; February, 3.86¾; March, 3.92½.

The fall in the New York rate during the summer months of 1920 was largely due to the preparations being undertaken by the Governments of Great Britain and France for the repayment, on 15th October of the same year, of the Anglo-French five-year loan of $500,000,000 raised in America during October, 1915. As early as 6th March, 1920, it was announced in London that this loan was to be repaid at maturity. Another influence operating to depress the exchange during the second half of 1920 was one that operated in pre-war years, namely the great exportations of American products, such as cereals and cotton, during August, September, October, and November, which always assume their largest proportions during these months.

The India and China exchanges all moved considerably in favour of London, the reaction from the previous adverse tendency being mainly due to the great fall in the price of silver, which on 1st April, 1921, was 32½d. per ounce standard, as against the record price of 89½d. per ounce standard on 11th February, 1920.

All the South American rates fell materially, the greatest percentage movement being shown by the Rio de Janeiro and Valparaiso rates. The Buenos Aires rate at 1st April, 1921, was again in proximity to parity. As in the case of those of other countries, the South American exchanges were largely affected by the demand for sterling to settle indebtedness due to imports of high-priced goods ordered six to twelve months prior to due date of settlement. Sterling exchange was scarce owing to the great fall in the prices of the products of South America, mainly foodstuffs and raw materials.

To some extent since the war terminated, speculation in various foreign currencies has caused sharp fluctuations in exchange rates, but the influence exerted by this cause has been mainly transient.

Nearly all the exchanges have shown, since 1919, the full effects of unprecedented monetary inflation during and since the war, the movements being particularly marked in the case of the exchanges of those countries from which Government control of rates was removed in 1919, and rates thereafter left to reflect the full effects of current economic and financial conditions in the different countries.

Since the above was written, and at the time (28th May, 1921) of passing the proofs of these pages for the printer, some material movements have taken place in several of the exchanges. Comparing rates ruling on 1st April with those ruling on 27th May, 1921, the French exchange has fallen from 56.09½ to 46.55½ ; the Belgian from 53.75½ to 46.60, and the Italian from 95.87½ to 73.37½. This appreciation in the currencies of France, Belgium, and Italy is partly to be attributed to tourist expenditure in such countries and partly to the acceptance by Germany, on 11th May, without reservations, of the revised indemnity conditions imposed by the Allied Governments. The New York cable rate, after rising to slightly over 4.00 by the middle of May, had receded to 3.91 by 27th May. This reaction was generally considered to be primarily due to Germany buying dollars for account of the Reparation Commission. The coal stoppage in this country and the beginning of forward purchases of dollars for ultimate settlement of the customary large imports of cotton and cereals from America during the autumn had probably also some influence in the reaction.

Trade Indebtedness of Europe to United States

As already stated, the depreciation of sterling and the currencies of Great Britain's Allies, as reflected by the New York exchanges on the various centres, was due in the main to the enormous purchases in value that had necessarily to be made during the war in America of foodstuffs, raw materials, and other goods. The following table conveys some indication of the extent of such purchases—

Trade of the United States with Europe

(In Thousands of Dollars)

Year Ending 30th June.	Imports.	Exports.	Excess of Exports.
	$	$	$
1915	614,355	1,971,435	1,357,080
1916	616,253	2,999,305	2,383,052
1917	610,471	4,324,513	3,714,042
1918	411,578	3,732,174	3,320,596
1919	372,951	4,644,938	4,271,987
1920	1,205,748	4,598,545	3,392,797
Totals . .	3,831,356	22,270,910	18,439,554

From the above table it will be observed that the balance of the trade indebtedness of Europe to the United States during the six years ending 30th June, 1920, amounted to $18,439,554,000, equivalent to about £3,700,000,000, if dollars be converted into sterling at the rate of $5 to £1.

Extreme Movements in Rates During 1919 and 1920

The extreme fluctuations in the rates of certain of the leading exchanges during the years 1919 and 1920 is shown in the table on following page.

The dates of the extreme rates during 1920 for Paris, Berlin, and New York were as follows: Paris, 12th April, 68.10; 5th January, 40.85. Berlin, 26th January, 365; 26th May, 129. New York, 6th April, 4.01⅞; 4th February, 3.21¾.

	Parity.	1919.		1920.	
		Highest.	Lowest.	Highest.	Lowest.
Paris . . .	25.22	45.30	25.97	68.10	40.85
Brussels . .	25.22	42.65	27.70	63.10	40.46
Berlin . . .	20.43	199	60[1]	365	129
Amsterdam .	12.107	11.87	9.86	11.48	8.73
Christiania .	18.159	19.10	16.57	26.55	18.60
Stockholm . .	18.159	18.45	16.20	18.45	17.12
Copenhagen .	18.159	21.45	17.67	25.85	19.65
Italy . . .	25.22	52.20	30.25[2]	105.60	50.00
Switzerland .	25.22	25.06	19.15	23.26	19.45
Madrid . . .	25.22	23.75	19.12	28.80	19.10
New York . .	$4.86\frac{2}{3}$	$4.78\frac{1}{2}$	3.69	$4.01\frac{7}{8}$	$3.21\frac{3}{4}$
Buenos Aires .	47.58d.	64d.	$50\frac{13}{16}$d.	73d.	$50\frac{3}{4}$d.

It may here be noted that the enormous fluctuations in exchange rates since the conclusion of peace has compelled traders to protect in advance the proceeds of trade transactions payable in currency by arranging forward exchange contracts with banks.

Sterling Expressed as at Premium or Discount Since January, 1920

Probably the best method of presenting to the mind the extent of disordered exchanges, and indicating any material improvement towards normal, is to express average rates over successive periods of time in the form of a premium or discount percentage, as the case may be, compared with parity. This is the method adopted by the Anglo-South American Bank in showing the trend of different rates, in a circular issued monthly by that bank. The table given on the next page has been extracted from the circular referred to. Restoration of the various exchanges towards parity, and, therefore, improvement in economic and financial conditions throughout the world, will be indicated by exchange rate premium or discount percentages gradually diminishing. It is obviously to the interest of all nations that adverse and favourable exchanges should come back to normal as soon as possible.

[1] Approximate.
[2] Fixed.

The trend of exchange rates since the commencement of 1920 is shown in the table below, which gives the monthly average of the exchanges in the leading centres expressed in the form of a premium or discount on sterling, as the case may be.

PREMIUM ON STERLING

Monthly Averages.	Jan., 1920.	Feb., 1920.	March, 1920.	April, 1920.	May, 1920.	June, 1920.	July, 1920.	Aug., 1920.	Sept., 1920.	Oct., 1920.	Nov., 1920.	Dec., 1920.	Jan., 1921.	Feb., 1921.	March, 1921.	April, 1921.
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
Paris . . .	69·79	91·00	103·92	150.46	125·17	98·65	87·11	100·00	106·54	110·30	126·88	133·62	131·59	114·03	119·66	115·42
Brussels . .	70·58	85·13	95·87	134·68	113·76	88.42	75·89	88·10	94·81	99·60	113·91	121·33	120·45	104·76	110·39	109·71
Rome . .	104·16	143·41	174·49	250·68	199·27	165·13	163·54	194·43	219·60	252·62	277·72	295·24	317·74	320·65	306·35	239·98
Berlin . .	987 96	1511·60	1412·48	1084·53	790·21	658·05	644·00	744·34	894·86	1050·88	1202·00	1147·55	1092·41	1055·16	1094·32	1120·02
Christiania .	5·51	7·77	13·61	9·04	13·61	24·37	29·38	33·02	38·44	38·99	41·58	31·29	17·46	20·16	33·05	35·86
Copenhagen .	15·09	25·39	20·38	19·86	32·17	28·88	29·85	33·15	38·48	37·09	41·25	29·95	14·73	15·59	24·35	19·61
Lisbon . .	202·66	211·33	228·88	250·44	324·55	354·00	373·57	333·11	372·66	424·88	527·33	661·09	718·00	753·11	928·22	921·51
Madrid . .	[1]22·38	[1]22·89	[1]16.71	[1]10·56	[1]8·94	[1]5·17	[1]3·60	[1]4·65	[1]5·37	[1]4·02	5·05	4·86	10·11	9·73	11·16	11·83
Bucharest .	569·97	807·83	843·51	863·33	744·40	597·72	470·86	530·32	554·11	673·04	807·83	974·33	1005·09	1017·93	1029·83	919·97
Helsingfors .	320·22	223·09	182·26	187·41	195·74	237·76	292·98	352·72	339·04	433·20	528·34	482·75	368·90	371·75	482·76	585·83
Athens . .	2·47	16·71	33·20	41·48	33·67	32·09	22·93	26·10	31·45	39·13	50·25	83·79	98·93	108·56	104·84	125·25
Rio de Janeiro	[1]10·02	[1]11·42	[1]9·86	[1]8·24	[1]3.03	5·79	12·28	15·84	26·73	30·61	34·74	48·84	62·00	61·00	74·29	85·51
Valparaiso .	36·16	15·30	26·33	37·88	50.04	52·44	50.03	50·94	56·56	73·44	82·29	83·50	98·13	102·86	100·00	136·12

DISCOUNT ON STERLING

Monthly Averages.	Jan., 1920.	Feb., 1920.	March, 1920.	April, 1920.	May, 1920.	June, 1920.	July, 1920.	Aug., 1920.	Sept., 1920.	Oct., 1920.	Nov., 1920.	Dec., 1920.	Jan., 1921.	Feb., 1921.	March, 1921.	April, 1921.
Amsterdam .	17·69	24·91	16·66	12·22	12·98	9·88	8·56	9·26	7·41	7·07	6·15	6·79	6·09	6·34	6·13	6·62
Stockholm .	2·09	[2]0·17	[2]0·72	0·71	[2]0·12	0·27	2·36	3·07	4·09	2·88	0·93	1·70	3·38	4·06	5·45	8·04
Zurich . .	17·94	18·45	13·68	13·10	13·81	13·93	12·90	13·63	14·21	13·35	12·35	10·09	5 28	6·09	8·98	10·25
New York .	24·04	30·64	24·07	19·38	21·03	18·82	20·26	25·71	27·74	28·58	29·39	28·28	23·18	20·42	19·67	19·29
Montreal . .	16·79	20·26	15·04	11·75	12·42	8·03	9·28	16·07	20·04	21·39	20·88	16·77	12·21	9·58	8·52	9·30
Buenos Aires .	29·18	34·21	28·67	20·97	20·83	17·46	16·44	16·66	15·87	15·47	11·11	11·31	5·57	3·43	0·20	[2]6·71
Monte Video .	19·15	27·02	21·28	14·47	17·66	12·98	9·15	10·42	11·28	9·57	6·17	3·83	[2]4·17	[2]5·70	[2]10·64	[2]22·30

[1] Discount. [2] Premium.

In the table given below, extracted from the same source, the premium and discount method is adopted to show the magnitude of the highest and lowest rates, and the average rate, for the year 1920.

Country.	Highest Rate 1920.	Premium (+) or Discount (–) on Sterling	Lowest Rate 1920.	Premium or Discount on Sterling.	Average Rate for Year.	Average Premium or Discount on Sterling.
		%		%		%
Paris . . .	68.10	+ 169·97	40.85	+ 61·94	52.62½	+ 108·62
Brussels . .	63.10	+ 150·15	40.46	+ 60·39	50.07½	+ 98·51
Rome . .	105.60	+ 318·63	50.00	+ 98·22	76.52	+ 203·36
Berlin . .	365	+ 1686·59	129	+ 531·42	226⅞	+ 1010·49
Christiania .	26.55	+ 46·21	18.60	+ 2·43	22.53	+ 24·07
Copenhagen .	25.85	+ 42·35	19.65	+ 8·21	23.48	+ 29·30
Lisbon . .	20¼d.	+ 163·33	6d.	+ 788·89	12⅝d.	+ 322·22
Bucharest .	320	+ 1168·58	125	+ 395·54	202.67	+ 703·44
Helsingfors .	178	+ 605·65	60	+ 137·86	104.67	+ 314·94
Athens . .	49.75	+ 97·22	25.30	+ 0·30	33.91	+ 34·44
Rio de'Janeiro	18½d.	– 13·51	9⅜d.	+ 70·66	14 7/32d.	+ 7·79
Valparaiso .	16 5/16d.	+ 10·37	9¼d.	+ 94·64	12⅛d.	+ 48·46
Amsterdam .	11.48	– 5·18	8.73	– 27.89	10.69⅞	– 11·63
Madrid . .	28.80	+ 14·17	19.10	– 24·28	23.24	– 7·87
Stockholm .	18.45	+ 1·60	17.12	– 5·72	17.90	– 1·43
Zurich . .	23.26	+ 7·79	19.45	– 22·89	21.70½	– 13·95
New York .	4.01⅞	– 17·41	3.20½	– 34·10	3.65¾	– 24·84
Montreal .	4.56½	– 6·19	3.69	– 24.17	4.10 1/16	– 15·72
Buenos Aires	73d.	– 34·77	50½d.	– 6·17	59⅞d.	– 20·43
Monte Video.	76d.	– 32·81	49¾d.	+ 2·64	59⅜d.	– 14·04

The average rate for Berlin reflects to a considerable extent the excessive issues of paper currency by Germany since 1917, particulars of which are shown later.

Expansion in Paper Issues

Throughout the war, and since, the extent of depreciation or appreciation of the various foreign currencies has been largely determined by the relative degree of monetary inflation in different countries. Any material increase in the amount of credit and currency, without compensating increased production, as is fully explained in another chapter, is invariably accompanied or followed by a rise in home prices, which naturally tends to reflect itself in exchange rates. It may here be stated that an expansion in bank credit usually precedes any great expansion in the amount of outstanding currency. The latter is largely a consequence of the

former, though economic conditions have some effect on the amount.

The enormous increase in the paper currencies of various countries since 1914 is shown in the tables given on the next two pages, the figures of which have been extracted from the monthly *Bulletin of Statistics* issued by the Supreme Economic Council. In some countries it will be observed that inflation has now been checked (including the United Kingdom), in others that it is still proceeding, and in others it is difficult to determine whether the turning point has yet been reached or not, owing to fluctuating amounts of outstanding notes, partly due to holiday requirements temporarily absorbing additional amounts of currency. The figures clearly prove that Germany and Austria have been the worst offenders in depreciating their currencies by increasing the number of units of available purchasing power. It is also interesting to observe that the outstanding note issues of all the neutral countries have materially increased since 1914, in their case the increase being drawn into circulation by the rise in world prices caused by the war and deliberate inflation in the belligerent countries.

On several occasions during the war it was pointed out by economists that the great and growing amounts of paper issues in European belligerent countries would make it exceedingly difficult for such countries to restore their exchanges to normal after the war.

The Future Course of the Exchanges

It is obvious that any attempt to indicate the course of the various exchanges during the next few years and the period of time that will probably elapse before rates again fall within the pre-war customary gold points would be mere guess-work, for the course of the exchanges for many years to come must necessarily be largely governed by the policies the Governments of different countries adopt in such matters as making revenue balance or exceed expenditure, deflation, trade barriers and tariffs. Industrial strife will also obviously have a material influence in retarding economic recovery. It will retard increased production at prices the general public can afford to pay. All such influences were fully considered by the International Financial Conference at Brussels in 1920, a brief review of the proceedings thereat being given in later pages. Other influences that will affect the exchanges are variations in

STATEMENT SHOWING THE FLUCTUATIONS IN THE NOTE CIRCULATION IN CERTAIN PRINCIPAL COUNTRIES SINCE 1913—IN £1,000's.

Foreign Currencies Converted at Approximately Par Rates

END OF	United Kingdom.		United States.		Bank of France.	Italy.		Germany.		Austro-Hungarian Bank.
	Currency Notes.[2]	Bank Notes.	Federal Reserve. Notes.	Other Paper Currency		Treasury Notes.	Bank Notes.[1]	Imperial Bank Notes.	Loan Bureau Notes.	
December—										
1913	—	29,608	—	536,407	228,542	19,963	91,340	127,511	—	103,902
1914	38,478	36,139	3,583	554,827	406,464	26,290	117,440	248,090	21,928	214,042
1915	103,125	35,309	42,444	595,046	532,394	43,284	158,723	340,131	47,347	298,417
1916	150,144	39,676	62,086	666,815	667,153	52,692	200,496	396,060	140,961	453,708
1917	212,782	46,591	255,676	547,149	893,472	69,952	337,000	563,831	307,636	767,917
1918	323,241	70,190	548,055	435,166	1,209,984	84,956	470,008	1,090,910	497,026	[4] 1,482,833
1919	356,152	[3] 87,350	622,847	374,123	1,490,982	90,808	651,252	1,755,169	673,191	2,270,053
1920	367,626	[3] 113,401	709,360	355,764	1,516,064	90,720	789,266	3,382,913	588,786	—
1920 January	329,554	[3] 84,258	592,686	359,099	1,503,300	—	625,384	1,840,966	632,037	2,365,533
March	335,372	[3] 99,371	634,268	359,123	1,493,374	90,772	637,264	2,220,848	671,914	[5] 2,493,480
May	348,316	[3] 103,614	645,902	360,866	1,516,593	101,436	674,444	2,415,436	663,681	—
July	361,912	[3] 106,869	648,100	367,046	1,507,835	—	715,954	2,741,956	652,420	2,664,319
September	353,795	[3] 108,791	682,997	372,778	1,568,318	—	756,492	3,035,328	653,020	2,870,889
October	355,872	[3] 108,839	697,804	370,467	1,563,376	—	772,053	3,126,825	637,134	3,037,609
November	349,284	[3] 109,215	691,545	375,946	1,542,932	—	779,053	3,160,651	605,534	3,209,341
December	367,626	[3] 113,401	709,360	355,764	1,516,064	90,720	789,266	3,382,913	588,786	—
1921 January	342,489	[3] 109,035	646,803	357,290	1,516,520	—	770,516	3,275,523	555,211	—
February	336,006	[3] 108,248	640,153	369,879	1,512,324	—	757,052	3,315,159	526,551	—
March	343,826	[3] 110,455	611,153	381,238	1,537,403	—	750,574	3,413,014	497,523	—

[1] Notes of the Bank of Italy, Bank of Naples, and Bank of Sicily.
[2] Excluding Notes called in, but not yet cancelled.
[3] Excluding Bank of England Notes held on Redemption Account in respect of Currency Notes.
[4] In addition there had been issued by the end of 1918 Short-term scrip notes (Kassencheine) to the amount of £309,083,000.
[5] On 7th March.

STATEMENT SHOWING THE FLUCTUATIONS IN THE NOTE CIRCULATION IN CERTAIN PRINCIPAL COUNTRIES SINCE 1913—IN £1,000's

Foreign Currencies Converted at Approximately Par Rates—Contd.

END OF	National Bank of Belgium.	Netherlands Bank.	National Bank of Denmark.	Bank of Norway.	Bank of Sweden.	Swiss National Bank.	Bank of Spain.	Bank of Japan.	National Bank of Greece.	National Bank of Roumania.
December—										
1913	42,696	26,058	8,420	5,978	13,026	12,553	77,268	43,669	[1]10,538	17,487
1914	64,570	39,426	11,479	7,455	16,892	18,236	78,944	39,491	[1]11,245	23,130
1915	52,820	46,451	12,247	9,012	18,216	18,624	84,007	44,053	[1]13,539	30,488
1916	51,260	63,198	15,826	13,970	23,195	21,461	94,403	61,575	[1]18,558	58,068
1917	50,720	74,189	18,770	18,129	31,818	28,092	111,944	85,146	[2]33,925	78,450
1918	128,420	89,079	25,002	24,234	45,196	39,028	133,371	117,240	[1]43,790	99,566
1919	190,552	86,061	27,186	25,239	41,531	41,445	154,252	159,268	[1]52,979	168,601
1920	244,770	89,345	30,928	26,576	42,215	40,948	173,050	147,402	[1]55,527	379,423
1920 January . .	196,106	86,341	26,375	22,975	37,403	37,933	154,371	140,840	54,589	177,109
March . . .	197,884	84,442	29,123	25,003	41,201	38,946	153,703	140,112	55,226	179,640
May . . .	202,759	85,069	28,647	24,025	39,349	38,156	154,705	135,995	55,347	184,948
July . . .	215,500	84,767	30,066	25,461	40,265	38,048	156,818	123,149	55,607	199,524
September .	229,442	85,859	31,082	26,561	43,320	39,599	161,837	119,828	58,786	306,814
October . .	231,713	88,110	32,114	26,581	42,934	39,885	168,720	122,081	59,448	—
November. .	233,832	89,836	30,846	25,190	41,824	38,744	168,292	120,852	58,950	366,808
December .	244,770	89,345	30,928	26,576	42,215	40,948	173,050	147,402	59,677	379,423
1921 January . .	248,964	89,342	29,009	23,520	37,631	37 557	171,971	126,485	60,012	383,146
February . .	238,747	87,785	28,250	23,169	38,202	37,776	169,704	116,755	60,923	408,872
March . . .	244,193	86,401	28,725	23,599	39,826	39,420	168,933	120,544	63,180	440,203

[1] At the end of June.
[2] At the end of December.

price movements in different countries (largely dependent on monetary deflation and production), the medium employed for internal currency, and the means adopted to liquidate international trade balances. Another important factor, the effects of which on the various exchanges cannot possibly be calculated beforehand, will be the series of indemnity payments yet to be made by Germany. Not only will the direct exchanges with Germany be affected by such payments, but movements will also indirectly be caused thereby in the exchanges between other countries, on account of the more or less interdependence of all exchanges. But notwithstanding the impossibility of forecasting the probable future course of the exchanges, for reasons stated above, yet broad statements may nevertheless be made with a certain amount of truth.

1. Subject to world-wide peace, restoration of international confidence, cessation of continuous industrial strife in various countries, the balancing of National Budgets, gradual deflation, both by reduction in available units of purchasing power and increased production, opening of the leading financial centres to foreign loans and subscription thereto by the investing public, freedom in international trade, and a price level and rates of wages that permit the working classes to enjoy a reasonable standard of living, the various exchanges should in the course of a few years be in proximity to their pre-war parities. Every country must ultimately work out its recovery for itself, and liquidate the inflation harvest. The smaller impoverished countries will require some initial help.

2. The interest factor in pre-war times was the main governing influence that tended to maintain exchange rates near their respective parities. By variation, it determined the amount of floating foreign balances in different countries, and the inflow of foreign money for temporary or permanent investment. It will prove the most powerful factor in future in liquidating the present appreciation or depreciation of the various currencies after international and industrial peace is fully restored.

Gold stocks, in pre-war times, functioned as a barometer, so to speak, that compelled interest rates so to be varied as to ensure a sufficient supply of commodities for everyday consumption. Alteration in interest rates regulated the due distribution of labour

between production of goods for current consumption and production of capital plant. Gold in itself, without the interest factor, was powerless to act as the regulator of economic conditions.

In an economic sense, an effective Bank Rate may be defined as that charge (on which other interest charges are based) on the community necessary to regulate the supply of floating commodities according to the current standard of living. In pre-war times, when there was temporary over-production, usually evidenced by a trade slump, a reduction in Bank Rate, sooner or later, followed, and indirectly eventually redressed the position by causing a diversion of labour from production of goods for current consumption to production of capital goods, i.e. new mills, extensions, plant, etc., and *vice versa* when Bank Rate was increased.

3. The New York-London exchange is in reality the main trunk line of exchange between America and Europe, for a large proportion of indebtedness between the Continent and America is eventually liquidated *via* London. Drafts drawn on London are sent by the Continent to America for imports from the latter, or sterling is by order transferred in London to New York account. Therefore, until there takes place a considerable improvement in the financial conditions generally of the Continent, it is exceedingly improbable that the New York–London exchange can approach near to parity. Apart from indebtedness caused by trade transactions, this important exchange will also be influenced to a considerable degree by the method eventually adopted to liquidate the present enormous indebtedness of European Governments to the United States. If such indebtedness be eventually funded in the United States, such action should be accompanied by marked improvement in the New York–London rate.

4. Notwithstanding that the course of the New York–London exchange will in the near future be largely governed by financial and economic conditions on the Continent, and the action taken in the matter of European Government indebtedness to the United States, there should nevertheless take place a gradual improvement in the value of sterling in America and in the few other countries in which sterling is at present at a discount, provided Great Britain's adverse trade balance is more than covered by invisible exports. When international trade revives, such net favourable balance is likely to exceed £100,000,000 per annum.

5. Any serious attempt by any of the larger nations during the next ten years or so entirely to replace internal paper currency by gold coin, or to support by the pre-war customary percentage gold basis the great amount of bank credit that will still remain after reasonable deflation, would have far-reaching effects on international trade, the various exchanges, and social conditions. High interest rates would tend to be maintained in consequence of efforts to attract gold from abroad, when economic conditions and the state of production warranted lower rates. A continuous struggle between nations to attract gold by maintaining high interest rates would probably eventually cause commodity prices to fall below the pre-war level, and during this process tend to create more or less continuous industrial strife, for money wages would have to be repeatedly reduced in the absence of compensating increased production. Between 31st December, 1913, and 31st December, 1920, bank credit in the United Kingdom expanded by about 140 per cent., and on the Continent, in certain countries, the percentage increase was considerably greater. In any struggle for gold, England will be in a preferential position, in that over 60 per cent. of the world's total production is contributed by the British Empire.

During the war, the world's production of gold rapidly decreased, but the proportion contributed by the British Empire showed an increasing tendency. For 1913 such proportion was 65 per cent.; for 1914, 62 per cent.; for 1917, 65 per cent.; for 1918, 65 per cent.; for 1919, 67 per cent; and for 1920, 69 per cent. The diminution of gold output during the war was largely brought about by increased cost of production, which was unaccompanied by a corresponding rise in the value of gold, but the table given on next page shows that a stationary tendency in production had already disclosed itself during the five years 1910–1914, and therefore the future course of production was, even before the war, an uncertain factor. Previous to 1910, it will be observed from the table, there was a very rapid expansion in production since 1891.

It is very obvious from the tendency of gold production since 1910 that, unless there be considerably increased production in immediate future years, the restoration of an effective gold standard in various countries cannot take place for a long period of time, particularly if banks attempt to restore

WORLD'S PRODUCTION OF GOLD

Year.	Value of Production (in Million £'s.) Annual.	Five Years.
1891	27	
1892	30	
1893	32	167
1894	37	
1895	41	
1896	42	
1897	49	
1898	59	269
1899	65	
1900	54	
1901	55	
1902	61	
1903	67	332
1904	71	
1905	78	
1906	82	
1907	85	
1908	91	446
1909	94	
1910	94	
1911	95	
1912	96	
1913	94	473
1914	91	
1915	97	
1916	93	
1917	87	
1918	79	404
1919	75	
1920	70[1]	

their customary pre-war percentage basis of gold to deposit liabilities.

What the requirements of that great permanent absorber of gold, India, will be in future years is not possible of estimation. That her demands for gold will be great is obvious from the following extract from a paper read by Mr. G. Findlay Shirras (Director of

[1] Subject to slight correction.

The figures in the above table have reference only to the standard value of gold, the premium on gold during and since the war being ignored.

Statistics, India), before the Royal Statistical Society on 15th June, 1920: "The pre-war average net imports into India of gold bullion were £7,000,000, and of sovereigns £12,000,000, a large part of which was used for melting down into jewellery, required for social and industrial purposes. In the five war years ending 31st March, 1919, India was not permitted to take gold in any quantity, as it was considered not to be in the interest of Allied finance. The average net imports in this period were only £5,000,000 a year, of which £2,000,000 were sovereigns, the remainder being in bullion and coined gold other than sovereigns. The yearly average supply of gold for private needs was reduced to a figure below that of any of the preceding 25 years, except famine years. . . ." In a table furnished by Mr. Shirras, the following figures were given to show the great pre-war absorption of gold by India—

NET ABSORPTION OF GOLD (BOTH COIN AND BULLION) BY INDIA

(*In Thousands of £ Sterling*)

1873-74	Average of Five Years Ending							1910-11
	1878-79	1883-84	1888-89	1893-4	1898-9	1903-4	1908-09	
1,285	594	3,394	2,297	2,010	2,330	4,307	10,667	18,127

These figures clearly prove a rapid progressive absorption of gold by India since the nineties of the last century.

Egypt was another country that, in pre-war times, annually absorbed large amounts of gold.

In the course of his lecture, Mr. Shirras expressed his opinion that the price of gold in the open market was likely to remain at a high level for a considerable time. All countries were anxious to secure as much gold as possible, and to deflate at the earliest possible opportunity. When everything was considered, including the possible falling off in the output of low-grade mines, the conclusion arrived at was that the pre-war price of gold in the open market was not likely to be realized for several years.

6. In the case of France and Italy, both these countries during the war lost for the time being their customary important invisible exports occasioned by the expenditure of travellers whilst sojourning therein. Since the war terminated, however, considerable numbers

of foreigners, especially American tourists, have visited France and Italy, largely with the object of viewing the great battlefields, in particular in France. Such invisible exports in the future will prove of material aid in accelerating improvement in the French and Italian exchanges towards normal.

7. One of the most important factors that will determine the course of the various exchanges in the near future, and retard improvement towards normal meanwhile, will be the length of time that elapses before the present stocks of high-priced goods are absorbed by consumption. If the merchant houses and retail trade, at home and abroad, refuse to reduce prices of their existing stocks proportionately to replacement cost, the process of clearance by the ultimate customer will be slow, and credit liquidation and unemployment will be correspondingly prolonged. The human factor, the disinclination to cut losses after a severe reduction in prices, is one of the worst fruits of inflation. In consequence, an enormous amount of bank and commercial credit is solidified in stocks held by traders and book debts. Such solidification reflects itself in an inequality between the decline of prices and the much slower decline of bank credit.

As soon as the greater part of the present stocks of high-priced goods have passed into consumption, there should follow some considerable increase in the *volume* of international trade, which will tend to reflect itself in an improvement in the various exchanges.

8. And, finally, a factor that must partly determine the time that will elapse before the restoration of certain exchanges to normal will be the policy eventually adopted by Great Britain in the matter of the great loans she made to her European Allies during the war. If such loans are not cancelled, payment of interest thereon and periodic instalments of principal will retard appreciation in the currencies of several Continental countries.

It is therefore clearly obvious that there are many variable factors that will influence the course of the exchanges in the future. But, in brief, it may be said that the future course of the exchanges will be largely determined by the restoration and maintenance of word-wide peace (international and industrial), hard work, the restoration of sound financial systems in all countries, and the removal of barriers to international trade, for such factors are basic in their ultimate influence on the exchanges. The absorption

by consumption of present stocks of high-priced goods, and the liquidation of credit that will follow, is but a matter of time.

Overseas Trade Balance

It has been already indicated that the main factor that caused the neutral exchanges to move adversely to London during the war was the rapidly increasing adverse trade balance. Purchases of foodstuffs, raw materials, and finished goods at rapidly rising prices had inevitably to be made abroad, particularly from the United States of America, largely on account of war requirements of Great Britain and her Allies. It was not possible to offset the increased value of imports by increased value of exports, because a large part of the man power of the United Kingdom had necessarily to be diverted to the armies for fighting purposes, for providing munitions, and other essential war equipment, and for performing services accessory to war. Consequently, the balance of trade during the war moved increasingly against Great Britain. The increased balance was only prevented from fully reflecting itself in the neutral exchanges by the operations of the Exchange Committee in London, to which reference has already been made. It has also to be borne in mind that the neutral exchanges, like all other exchanges, were affected to a material extent by the interruption and diversion of international trade from its pre-war customary channels.

The value of the total imports, total exports (including re-exports) and the trade balance of the United Kingdom since the year 1910 are shown in the table on following page.

The main features disclosed by an examination of the amounts in the table are as follows—

(*a*) The value of disclosed imports increased rapidly from 1915. The amount for 1918 exceeded the amount for 1913 by £547,416,000, and the amount for 1920 exceeded the amount for 1918 by £620,591,000, or a total increase since 1913 of £1,168,007,000. (Various restrictions were placed on imports during the war, but they were all abolished on 1st September, 1919.)

(*b*) The value of disclosed exports decreased during 1914–1918, but increased greatly during 1919 and 1920. The amount for 1920 exceeded the amount for 1918 by £1,025,611,000 or for 1913 by £923,155,000.

VALUE OF IMPORTS AND EXPORTS (UNITED KINGDOM)

Year.	Total Imports.[1]	Total Exports.[2]	Excess of Imports Over Exports.
	£	£	£
1910 . .	678,257,024	534,145,817	144,111,207
1911 . .	680,157,527	556,878,432	123,279,095
1912 . .	744,640,631	598,961,130	145,679,501
1913 . .	768,734,739	634,820,326	133,914,413
1914[3] . .	696,635,113	526,195,523	170,439,590
1915[3] . .	851,893,350	483,930,629	367,962,721
1916[3] . .	948,506,492	603,845,885	344,660,607
1917[3] . .	1,064,164,678	596,757,207	467,407,471
1918 . .	1,316,150,903	532,364,078	783,786,825
1919 . .	1,626,156,212	963,384,677	662,771,535
1920 . .	1,936,742,120	1,557,974,984	378,767,136

The above figures are exclusive of Bullion and Specie.

(*c*) The excess value of imports over exports increased rapidly during 1914-1918, but diminished greatly during 1919 and 1920. A large part of the disclosed increase in the adverse trade balance was due to the great rise in prices after the commencement of the war.

In pre-war times the excess value of imports over exports of merchandise was well covered by invisible exports, i.e. payments due from abroad to the United Kingdom for shipping, insurance, banking, and other services, and interest on foreign investments, in fact there was an invisible balance in favour of the United Kingdom of, roughly, £200,000,000 per annum, which was absorbed by additional investments abroad.[4] During the war the trade

[1] The values of the Imports represent the cost, insurance, and freight; or, when goods are consigned for sale, the latest sale value of such goods.

[2] The values of the Exports represent the cost and the charges of delivering the goods on board the ship, and are known as the " free on board " values.

[3] The figures for the period from August, 1914-June, 1917, inclusive, include, in the case of Imports, all articles of food, but do not include other goods which, at the time of importation, were known to be the property of H.M. Government or the Governments of the Allies. In the case of goods exported, the figures for this period include goods bought in the United Kingdom by, or on behalf of, the Governments of the Allies, but do not include goods taken from British Government stores and depôts, or goods bought by H.M. Government and shipped on Government vessels.

Since July, 1917, the figures include merchandise imported or exported in public as well as in private ownership, except exports for the use of His Majesty's Forces on active service.

[4] Before the war, for the five years 1909-1913, the adverse trade balance averaged £140,000,000 per annum. The invisible exports for the same period were estimated at about £350,000,000 per annum, leaving excess accumulations of capital abroad of at least £200,000,000 per annum.

balance obviously considerably exceeded the amount of invisible exports. For 1919, however, the difference between the two is generally considered to have been small, owing to the great increase in shipping and marine insurance earnings, and notwithstanding reduced income from investments abroad. But for 1920 the Board of Trade estimated invisible exports to have *exceeded* the adverse trade balance by about £165,000,000, the basis for such estimate[1] being shown below—

1920.	£	£
Excess of Imports over Exports of Merchandise		378,800,000
Subtract Excess of Exports of Bullion and Coin valued at about		43,500,000
		335,300,000
Invisible Exports—		
Net National Income from Investments abroad	120,000,000	
Banking and Other Services	40,000,000	
Shipping services[2]	340,000,000	
		500,000,000
Net Balance in favour of United Kingdom		165,000,000 (about)

The restoration of a favourable balance of whatever amount (when invisible exports are taken into account), so soon after the termination of the war, is exceedingly gratifying. It was due, in the main, as already shown, to a greater increase in high-priced exports than in imports, notwithstanding the actual quantity exported in 1920 was less than in 1913, as explained later; and to very great receipts from shipping services. When international trade revives, a favourable net invisible balance of at least £100,000,000 should be maintained in future years,[3] though the amount may vary considerably each year until some stabilization of the price level. The great fall in freights will reflect itself in the total amount of invisible exports, but will probably be more than compensated for by a lesser adverse trade balance.

So far the disclosed overseas trade figures have been considered from the value standpoint. In view of the enormous increase in the value of imports since 1915 and the enormous increase in the value of exports during 1919 and 1920, it is startling to find from

[1] The *Board of Trade Journal*, 3rd February, 1921.
[2] Before the war, freightage receipts were estimated at about £100,000,000 per annum.
[3] For 1921 the true net balance may be slightly adverse.

figures that the annual volumes of imports and exports, even in 1920, were actually less than the volumes in the pre-war year 1913. In the following statement, which was prepared by the Board of Trade, in reply to a question asked in the House of Commons in November, 1919, there is shown the total estimated weight of imports for each of the years 1913–1918, exclusive of certain goods imported on Government account, as explained in the footnote.

Period.	Value of Imports.[1]	Estimated Weight of Imports.[1]	Average Value per Ton.
Year.	£	Tons.	£
1913 . . .	768,735,000	54,548,000	14
1914 . . .	696,635,000	46,368,000	15
1915 . . .	851,893,000	45,470,000	19
1916 . . .	948,506,000	41,356,000	23
1917 . . .	1,064,165,000	33,957,000	31
1918 . . .	1,316,151,000	35,167,000	37

The following particulars relating to the volume of overseas trade for the years 1919 and 1920 compared with 1913 were published in the *Board of Trade Journal* dated 20th January, 1921—

TRADE OF 1920 COMPARED WITH THAT OF 1919

Considering first the comparison of the trade of the year 1920 with that of the preceding year, taken as a whole, the values as declared were as follows—

	1920.	1919.	Increase in 1920
	Thousand £.	Thousand £.	Thousand £.
Total Imports . . .	1,936,742	1,626,156	310,586
Re-Exports	222,406	164,746	57,660
Exports (U.K. Goods) .	1,335,569	798,638	536,931

The comparison of these two years, when the goods are calculated at the average values shown in the 1913 records, yields the following results—

[1] The figures for the period from the beginning of the war up to July, 1917, include all articles of food, but do not include other goods which at the time of importation were known to be the property of His Majesty's Government or the Governments of the Allies.

VALUE ON BASIS OF 1913 PRICES

	Trade of 1920.	Trade of 1919.	Trade of 1913.
	Thousand £.	Thousand £.	Thousand £.
Total Imports . . .	679,274	679,786	768,735
Re-Exports	98,909	85,726	109,567
Exports (U.K. Goods) .	372,476	288,105	525,254

For convenience, these results may be stated in comparative form as follows—

	Volume of Trade.		Average Price Level.	
	Per cent. of that of 1913.		Per cent. of that of 1913.	
	1920.	1919.	1920.	1919.
Total Imports	88·4	88·4	285	240
Re-Exports	90·3	78·2	225	192
Exports (U.K. goods) . .	70·9	54·9	358	277

We see, accordingly, that imports in 1920 were of no greater total volume than in 1919, being 11·6 per cent. less than in 1913; that re-exports were about 15 per cent. more than in 1919 and 10 per cent. less than in 1913, and that, taking the year 1920 as a whole, the export trade showed an expansion in volume compared with 1919 of 29 per cent., but was still 29 per cent. below the level of 1913. The price movements in the different departments of the trade were by no means similar, and export prices advanced to a notably greater extent than prices of imports.

Another source of information as to the relative volume of overseas trade in different years, and the effect of price changes, is *The Economist.* That journal for some forty years past has taken the trouble to calculate from the trade statistics how much of the variation in the value of imports and exports from year to year is due to changes in volume and how much to alteration in price. The tables given on the next two pages show the result of *The Economist's* calculations of the relative volume of trade in 1919 and 1920 compared with that in 1913, the value amounts in the second and third columns obviously being proportionate to the relative volumes. It will be observed from a comparison of figures that the calculations made by *The Economist* of the value amounts for 1919 and 1920 at prices of 1913, differ little from the corresponding amounts calculated by the Board of Trade.

Overseas Trade of United Kingdom

Articles.	Value in 1920.		Actual Value in 1913.	1920 Compared With 1913 Increased or Decreased Value.		
				Due to Variation in		Actual Change Recorded.
	Actual in 1920.	At Prices of 1913.		Quantity.	Price.	
	£	£	£	£	£	£
Imported	1,936,742,000	674,955,000	768,735,000	- 93,780,000	+ 1,261,787,000	+ 1,168,007,000
Re-exported	222,406,000	97,166,000	109,575,000	- 12,401,000	+ 125,240,000	+ 112,839,000
Retained for home consumption	1,714,336,000	577,789,000	659,160,000	- 81,379,000	+ 1,136,547,000	+ 1,055,168,000
Exports of Brit. Produce	1,335,569,000	359,245,000	525,245,000	- 166,009,000	+ 976,324,000	+ 810,315,000
Balance of Imports . .	378,767,000	218,544,000	133,915,000	+ 84,630,000	+ 160,223,000	+ 245,853,000
Total Trade .	3,494,717,000	1,131,366,000	1,403,555,000	- 272,190,000	+ 2,363,351,000	+ 2,091,161,000

Overseas Trade of United Kingdom.

Articles.	Value in 1919.		Actual Value in 1913.	1919 Compared With 1913. Increased or Decreased Value.		
				Due to Variation in		Actual Change Recorded.
	Actual in 1919.	At Prices of 1913.		Quantity.	Price.	
	£	£	£	£	£	£
Imported	1,631,902,000	688,519,000	768,735,000	- 80,216,000	+ 943,383,000	+ 863,167,000
Re-exported	164,322,000	95,855,000	109,575,000	- 13,720,000	+ 68,467,000	+ 54,747,000
Retained for Home Consumption	1,467,580,000	592,664,000	659,160,000	- 66,496,000	+ 874,916,000	+ 808,420,000
Exports of Brit. Produce	798,373,000	289,457,000	525,245,000	- 235,788,000	+ 508,916,000	+ 273,128,000
Balance of Imports	669,207,000	303,207,000	133,915,000	+ 169,292,000	+ 366,000,000	+ 535,292,000
Total Trade	2,594,597,000	1,073,831,000	1,403,555,000	- 329,724,000	+ 1,520,766,000	+ 1,191,042,000

Direction of Overseas Trade

So far the overseas trade of the United Kingdom has been considered without particular reference to its direction, which obviously has a material influence on exchange rates between the various centres. It has to be borne in mind, however, that settlement, whether for imports or exports, is not necessarily made directly between the two countries concerned in the export and import transaction, but often through one or more intermediary countries that have had no direct concern in the trade transaction. For instance, the Continent effects settlement *via* London for the greater part of its trade transactions with America. It has also to be remembered that it is the final balances between various countries, whether due to trade, security, or credit transactions, that ultimately determine the course of exchange rates.

In the immediate following pages the direction of the disclosed overseas trade of the United Kingdom for the six years 1915–1920, together with figures for the year 1913 for the purpose of comparison, is shown in a series of tables containing classified groups of countries. The classifications are those adopted by *The Economist*, the figures being extracted from the Board of Trade Returns. (Some of the amounts differ from those shown by *The Economist.*) In studying these tables, it is necessary to bear in mind that overseas trade values were considerably inflated during 1915–1920 by the great rise in prices, particularly the declared values for the two years 1919 and 1920. The fall in wholesale prices, it is true, commenced, in the case of the United Kingdom, in April, 1920, but the greater part of the overseas trade for 1920 represented completion of contracts arranged before the commencement of the fall in prices, or before it had proceeded to a material degree. But whatever the extent the declared values of overseas trade for 1920 were affected by the reaction in prices, it may be observed that imports were probably more affected than exports, because a fall in prices of raw materials must necessarily precede a fall in prices of manufactured goods.

The main features disclosed by an examination of the tables may be summarized as follows—

1. During the war years 1915–1918, declared values of—

(*a*) Exports to France, Russia, and Italy (during 1916 and 1917), increased considerably, particularly in the case of France. Imports

from France and Russia greatly diminished, but increased from Italy. Little trade was done with Russia during 1918, owing to the disturbed conditions in that country following the Revolution.

(*b*) Exports to the United States show no great change, except a material reduction for 1918, but an enormous progressive increase is shown in imports from that country.

(*c*) Exports to Japan and China show material reduction, but a great increase is shown in imports from these two countries, particularly in the case of Japan.

(*d*) Exports to British Possessions, taken as a whole, show some reduction, which was considerable for 1915, but imports therefrom show great and progressive expansion.

(*e*) Exports to European neutrals show practically no change for 1915 and 1917, increase for 1916, and decrease for 1918, but imports therefrom show expansion for the whole four years, particularly from Spain, Norway, and Holland. (In the case of Holland a marked reduction is shown for 1918.) Imports from Denmark, however, show a reduction for each of the years 1915–1918, as compared with 1913.

(*f*) Exports to Brazil and Argentina show material reduction, but imports from Argentina, Chile, and certain other South American countries show considerable expansion.

2. During 1919 and 1920 (Peace signed with Germany, 28th June, 1919), declared values of—

(*a*) Exports to European countries considerably increased. Imports therefrom also show considerable expansion, but in the case of Denmark the value for 1919 was less than half that for 1913. Trade was resumed with Germany and other former enemy States. A fairly considerable trade was done with Russia, presumably the major part through the intermediary of neighbouring countries.

(*b*) Exports to other foreign countries also show considerable increase, but in the case of Chile the value for 1919 was less than that for 1913 or 1918. Great expansion took place in imports from such countries, particularly from Argentina and China, but the increase was relatively small in the case of imports from the United States. Imports from Chile, though being greater than the value for 1913, show a considerable reduction as compared with the value for 1918.

(*c*) Exports to British Possessions show some increase for 1919, but very great expansion for 1920, the value for the latter year being nearly two-and-a half times that for the former year, or for 1913. Imports from British Possessions considerably increased during 1919, but slightly diminished during 1920. In the case of imports from Canada a reduction is shown for both years.

(*d*) Re-exports considerably increased during 1919 and 1920.

EXPORTS TO ALLIES AND BRITISH POSSESSIONS DURING THE WAR YEARS 1915-1918

(000's Omitted)

	1913.	1915.	1916.	1917.	1918.
To—	£	£	£	£	£
France	32,396	72,497	98,272	118,206	137,355
Russia	18,103	13,432	24,978	48,737	298
Italy	14,640	13,955	20,461	27,474	29,273
Belgium	13,528	624	1,091	1,748	1,421
Portugal	6,053	4,751	6,017	4,702	5,295
Greece	2,537	2,467	1,265	183	1,048
	87,257	107,726	152,084	201,050	174,690
United States	30,478	26,832	33,246	33,721	23,559
Cuba	2,214	1,782	2,059	2,013	1,963
Brazil	12,465	5,151	6,718	7,186	8,836
Japan	14,783	4,954	7,548	5,570	6,044
China	14,845	8,546	10,707	10,624	11,832
British Exports to Allies	162,042	154,991	212,362	260,164	226,924
Canada	23,795	13,293	18,018	16,202	14,280
Australia	34,470	28,966	35,947	22,115	26,217
New Zealand	10,838	9,374	12,073	7,037	7,706
India and Ceylon	74,458	47,560	55,534	62,076	51,138
South Africa	22,185	18,291	23,078	19,992	23,453
Egypt	9,805	8,053	11,225	14,793	22,235
West Africa	6,601	5,730	7,092	8,381	7,961
Mauritius	536	733	914	544	512
Straits Settlements	5,836	3,671	5,234	4,890	6,140
West Indies	2,339	1,837	2,139	2,054	1,695
Other Possessions	14,249	10,912	14,922	14,574	17,176
British Exports to Possessions	205,112	148,420	186,176	172,658	178,513
Re-exports to Allies	63,023	60,231	62,666	53,581	24,421
Re-exports to Possessions	13,774	12,368	14,534	7,494	5,084
Total to Allies & Possessions	443,951	376,010	475,738	493,897	434,942

EXPORTS TO NEUTRALS DURING THE WAR YEARS 1915–1918 (000's Omitted.)

	1913.	1915.	1916.	1917.	1918.
To—	£	£	£	£	£
Sweden	8,220	6,279	6,574	3,074	2,628
Norway	6,147	7,287	10,897	8,453	5,437
Denmark	6,061	8,035	11,873	7,210	3,697
Netherlands	22,794	24,266	32,533	28,103	22,662
Switzerland	4,212	3,602	4,561	6,445	8,630
Spain	9,728	7,478	9,905	5,067	4,158
	57,162	56,947	76,343	58,352	47,212
Argentina	22,641	11,516	13,949	12,879	17,613
Mexico	2,333	249	348	917	1,094
Chile	6,010	1,791	4,034	4,638	6,384
Peru	1,488	591	1,081	1,495	1,530
Uruguay	2,916	1,497	1,899	2,277	3,151
Other Countries[1] . . .	65,541	8,867	10,088	13,700	16,052
British Exports to Neutrals	158,091	81,458	107,742	94,258	93,036
Re-exports to Neutrals .	[1]32,778	26,463	20,367	8,602	1,451
Total Exports to Neutrals .	190,869	107,921	128,109	102,860	94,487

IMPORTS FROM ALLIES AND BRITISH POSSESSIONS DURING THE WAR YEARS 1915–1918 (000's Omitted.)

	1913.	1915.	1916.	1917.	1918.
From—	£	£	£	£	£
France	49,498	35,449	31,067	28,473	39,466
Russia	40,271	21,435	18,252	17,937	6,730
Italy	8,131	11,278	11,243	10,397	18,413
Belgium	23,426	2,931	4,480	3,492	1,763
Portugal	3,898	5,325	6,803	4,859	12,442
Greece	2,202	3,935	4,687	958	2,392
	127,426	80,353	76,532	66,116	81,206
United States	143,854	239,945	295,829	380,287	522,078
Cuba	3,675	8,240	13,052	17,771	22,330
Brazil	10,008	8,257	9,037	9,985	8,850
Japan	4,389	9,379	12,495	15,299	23,883
China	4,672	7,035	8,335	8,497	9,708
Total from Allies . . .	294,024	353,209	415,280	497,955	668,055
Canada	30,488	40,989	58,529	84,385	124,468
Australia	38,065	45,190	36,178	64,289	45,696
New Zealand	20,338	30,408	31,627	29,088	24,812
India and Ceylon . .	56,218	74,411	83,096	77,026	101,060
South Africa	12,495	11,463	12,323	12,060	12,940
Egypt	21,395	21,791	26,606	32,484	54,140
West Africa	5,174	9,537	11,965	14,845	19,158
Mauritius	293	3,923	2,715	1,912	3,628
Straits Settlements . .	15,880	16,571	16,015	16,044	10,807
Malay States	3,574	3,433	6,284	6,984	2,144
West Indies	2,110	4,074	5,018	6,216	8,107
Other Possessions . .	6,875	10,025	12,317	13,697	18,059
Total from Possessions . .	212,911	271,815	302,673	359,030	425,019
Total from Allies & Possessions	506,935	625,024	717,953	856,985	1093,074

[1] Including enemy countries (Germany, in 1913, £40,677,000.)

Imports from Neutrals During the War Years 1915–1918

(000's Omitted.)

	1913.	1915.	1916.	1917.	1918.
From—	£	£	£	£	£
Sweden	14,213	19,802	20,606	14,939	22,375
Norway	7,437	13,690	16,659	18,373	23,763
Denmark	24,053	22,894	22,954	18,338	5,339
Netherlands	27,913	38,103	41,221	37,237	17,218
Switzerland	11,070	15,252	15,510	11,310	13,095
Spain	15,976	20,841	27,487	22,462	31,331
	100,662	130,582	144,437	122,659	113,121
Argentina	42,485	63,877	51,594	48,428	63,116
Mexico	1,880	2,228	2,573	2,316	5,125
Chile	5,359	9,585	12,409	13,223	19,334
Peru	3,178	3,313	4,789	4,673	8,006
Uruguay	2,749	4,331	3,997	5,456	6,542
Other Countries[1] . . .	105,487	12,953	10,755	14,228	11,020
Total from Neutrals . .	261,800	226,869	230,554	210,983	226,264

Exports to European Countries

(000's Omitted.)

To	1913.	1915.	1916.	1917.	1918.	1919.	1920.
	£	£	£	£	£	£	£
France . . .	32,396	72,497	98,272	118,206	137,355	155,384	146,600
Italy	14,640	13,955	20,461	27,474	29,273	27,771	39,737
Switzerland . .	4,212	3,602	4,561	6,445	8,630	13,627	12,641
Spain . . .	9,728	7,478	9,905	5,067	4,158	12,677	23,165
Portugal . . .	6,053	4,751	6,017	4,702	5,295	9,602	17,658
Belgium . . .	13,528	624	1,091	1,748	1,421	49,281	50,107
Germany. . .	40,677	—	—	—	—	14,696	21,723
Austria-Hungary	4,481	—	—	—	—	1,486	3,969
Greece . . .	2,537	2,467	1,265	183	1,048	6,891	12,782
Roumania . .	1,947	487	46	701	—	5,583	7,122
Turkey (Europ'n)	2,414	232	90	214	489	12,254	18,861
Russia . . .	18,103	13,432	24,978	48,737	298	12,765	11,893
Sweden . . .	8,220	6,279	6,574	3,074	2,628	24,447	39,332
Norway . . .	6,147	7,287	10,897	8,453	5,437	27,416	33,387
Denmark . .	6,061	8,035	11,873	7,210	3,697	35,005	31,688
Netherlands . .	22,794	24,266	3[illegible],533	28,103	22,662	43,382	71,499
	193,938	165,392	228,563	260,317	222,391	452,267	542,164

[1] Including enemy countries (Germany, in 1913, £80,411,000).

IMPORTS FROM EUROPEAN COUNTRIES

(000's Omitted.)

From	1913.	1915.	1916.	1917.	1918.	1919.	1920.
	£	£	£	£	£	£	£
France . . .	49,498	35,449	31,067	28,473	39,466	52,565	82,560
Italy	8,131	11,278	11,243	10,397	18,413	14,690	17,930
Switzerland . .	11,070	15,252	15,510	11,310	13,095	14,852	37,005
Spain . . .	15,976	20,841	27,487	22,462	31,331	39,290	42,549
Portugal . . .	3,898	5,325	6,803	4,859	12,442	14,654	10,489
Belgium . . .	23,426	2,931	4,480	3,492	1,763	10,197	45,750
Germany. . .	80,411	201	103	49	8	993	31,126
Austria-Hungary	7,706	48	7	—	—	506	2,623
Greece . . .	2,202	3,935	4,687	958	2,392	10,746	6,772
Roumania . .	2,037	5	—	—	—	3	3,228
Turkey (Europ'n)	1,165	1,063	76	23	30	2,682	3,119
Russia . . .	40,271	21,435	18,252	17,937	6,730	16,678	34,183
Sweden . . .	14,213	19,802	20,606	14,939	22,375	35,578	56,372
Norway . . .	7,437	13,690	16,659	18,373	23,763	17,070	23,859
Denmark . .	24,053	22,894	22,954	18,338	5,339	9,797	31,671
Netherlands . .	27,913	38,103	41,221	37,237	17,218	44,093	74,294
	319,407	212,252	221,155	188,847	194,365	284,394	503,530

EXPORTS TO OTHER FOREIGN COUNTRIES

(000's Omitted.)

To	1913.	1915.	1916.	1917.	1918.	1919.	1920.
	£	£	£	£	£	£	£
United States .	30,478	26,832	33,246	33,721	23,559	34,416	78,524
Cuba	2,214	1,782	2,059	2,013	1,963	1,974	7,246
Mexico . . .	2,333	249	348	917	1,094	1,312	4,327
Argentina . .	22,641	11,516	13,949	12,879	17,613	21,208	42,840
Brazil . . .	12,465	5,151	6,718	7,186	8,816	10,757	24,329
Chile	6,010	1,791	4,034	4,638	6,384	4,792	9,694
Peru	1,488	591	1,081	1,495	1,530	1,711	4,718
Uruguay . .	2,916	1,497	1,899	2,277	3,151	3,230	5,933
Japan . . .	14,783	4,954	7,548	5,570	6,044	12,835	26,337
China. . . .	14,845	8,546	10,707	10,624	11,832	20,976	43,542
Turkey (Asiatic)	5,291	132	336	708	1,296	9,871	18,861
Other Countries	10,731	7,852	9,616	12,077	14,287	17,348	25,571
	126,195	70,893	91,541	94,105	97,569	140,430	291,922

IMPORTS FROM OTHER FOREIGN COUNTRIES

(000's Omitted.)

From	1913.	1915.	1916.	1917.	1918.	1919.	1920.
	£	£	£	£	£	£	£
United States .	143,854	239,945	295,829	380,287	522,078	546,672	569,738
Cuba	3,675	8,240	13,052	17,771	22,330	17,378	25,629
Mexico . . .	1,880	2,228	2,573	2,316	5,125	7,187	13,466
Argentina . .	42,485	63,877	51,594	48,428	63,116	81,826	128,039
Brazil	10,008	8,257	9,037	9,985	8,850	10,945	12,160
Chile	5,359	9,585	12,409	13,223	19,334	7,294	12,981
Peru	3,178	3,313	4,789	4,673	8,006	8,860	14,582
Uruguay . .	2,749	4,331	3,997	5,456	6,542	10,515	7,065
Japan . . .	4,389	9,379	12,495	15,299	23,883	23,880	29,876
China. . . .	4,672	7,035	8,335	8,497	9,708	23,079	26,919
Turkey (Asiatic)	4,251	750	781	444	665	6,776	9,040
Other Countries	9,917	10,876	9,788	9,908	10,317	18,635	22,986
	236,417	367,816	424,679	516,287	699,954	763,047	872,481

EXPORTS TO BRITISH POSSESSIONS

(000's Omitted.)

To	1913.	1915.	1916.	1917.	1918.	1919.	1920.
	£	£	£	£	£	£	£
Canada . . .	23,795	13,293	18,018	16,202	14,280	16,019	42,782
Australia. . .	34,470	28,966	35,947	22,115	26,217	26,361	62,486
New Zealand .	10,838	9,374	12,073	7,037	7,706	9,595	26,601
India and Ceylon	74,458	47,560	55,534	62,076	51,138	73,295	187,730
South Africa .	22,185	18,291	23,078	19,992	23,453	20,012	50,530
Egypt . . .	9,805	8,053	11,225	14,793	22,235	19,417	43,663
West Africa .	6,601	5,730	7,092	8,381	7,961	12,261	23,234
Mauritius . .	536	733	914	544	512	845	2,745
Straits Settlements	5,836	3,671	5,234	4,890	6,140	6,293	16,568
West Indies .	2,339	1,837	2,139	2,054	1,695	2,168	5,947
Other Possessions	14,249	10,912	14,922	14,574	17,176	19,429	39,197
Total . . .	205,112	148,420	186,176	172,658	178,513	205,695	501,483

IMPORTS FROM BRITISH POSSESSIONS

(000's Omitted.)

From	1913.	1915.	1916.	1917.	1918.	1919.	1920.
	£	£	£	£	£	£	£
Canada . . .	30,488	40,989	58,529	84,385	124,468	115,295	92,854
Australia. . .	38,065	45,190	36,178	64,289	45,696	111,682	112,709
New Zealand .	20,338	30,408	31,627	29,088	24,812	52,680	47,743
India and Ceylon	56,218	74,411	83,096	77,026	101,060	125,975	112,593
South Africa .	12,495	11,463	12,323	12,060	12,940	23,512	20,235
Egypt . . .	21,395	21,791	26,606	32,484	54,140	60,731	69,336
West Africa .	5,174	9,537	11,965	14,845	19,158	26,470	30,660
Mauritius . .	293	3,923	2,715	1,912	3,628	7,320	7,024
StraitsSettlements	15,880	16,571	16,015	16,044	10,807	21,353	17,957
Malay States .	3,574	3,433	6,284	6,984	2,144	6,875	6,973
West Indies .	2,116	4,074	5,018	6,216	8,107	11,174	14,666
Other Possessions	6,875	10,035	12,317	13,697	18,059	21,404	27,981
Total from Possessions . . .	212,911	271,825	302,673	359,030	425,019	584,471	560,731

RE-EXPORTS

(000's Omitted.)

To	1913.	1915.	1916.	1917.	1918.	1919.	1920.
	£	£	£	£	£	£	£
France . . .	12,072	12,728	14,904	16,500	13,742	35,814	40,097
Italy	1,012	3,690	3,539	4,382	4,249	5,689	5,624
Belgium . . .	7,436	114	77	88	11	17,567	19,522
Germany. . .	19,823	—	—	—	—	8,491	29,376
Russia . . .	9,591	11,472	9,353	4,003	10	4,456	4,842
Sweden . . .	1,014	3,880	2,332	190	123	5,238	5,006
Norway . . .	518	2,058	1,361	894	208	2,169	1,942
Denmark . .	590	4,151	2,817	825	246	6,020	6,148
Netherlands . .	5,160	12,604	9,127	4,025	406	26,344	14,576
United States .	30,222	29,402	31,883	26,914	3,481	31,481	53,964
Japan . . .	297	301	466	325	1,358	1,816	1,912
Other Countries.	8,066	6,695	7,174	4,037	2,038	9,595	13,931
Total to Foreign Countries . .	95,801	87,095	83,033	62,183	25,872	154,680	196,940
British Possessions	13,774	12,131	14,533	7,494	5,084	9,642	25,466
Total . . .	109,575	99,226	97,566	69,677	30,956	164,322	222,406

EXPORT CREDITS SCHEME

This scheme, which first came into operation on 9th September, 1919, was instituted by the British Government with the object of facilitating exports to the following impoverished countries of Europe: Finland, Latvia, Esthonia, Lithuania, Poland, Czecho-Slovakia, Yugo-Slavia, Roumania, Georgia, and Armenia. Bulgaria was added to the list on 26th October, 1920, and Austria on 18th February, 1921. The scheme was intended not only to afford importers in such countries a reasonable term of credit, but also to overcome for a while the extreme difficulties of settlement for imports owing to exceptionally depreciated currencies. Since its institution it has undergone certain modifications. Under it, as originally framed, the Government stated they were prepared, through the Export Credits Department of the Board of Trade, to consider applications for advances by potential exporters in this country up to 80 per cent. of the cost of the goods to the exporter (including freight, insurance, and commission payable to the department by the exporter availing himself of the scheme). The importer in the impoverished country had to agree with the exporter in this country to take up the bills of lading against a deposit of currency which, calculated on the basis of the current exchange rate, was to be the equivalent of the amount of the draft plus an agreed upon margin to be maintained. This deposit was to be made with the department's agents in the importing country, to be held as security for the eventual payment of the bill of exchange. Alternative cover was approved deposit of produce or securities. The above undertaking had to be guaranteed by an approved bank of the country of purchase or elsewhere before the department made an advance against the shipping documents. The advance was to be a first charge upon the proceeds of the bill and deposited security, but if such proceeds were less than the cost (including freight, insurance, and commission paid to the department), the loss represented by the difference was to be shared between the department and the drawer of the bill, the share of the department being in the proportion which the advance bore to such cost. The credits were to be granted for such periods as the department might determine in each case, and might be granted up to a maximum period of three years. Advances were not to be made for the export of raw materials or of surplus Government

stores, and preference was to be given to the finance of goods where the larger part of the cost was due to manufacture or production in this country. Interest was to be payable at the rate of 1 per cent. above English Bank Rate, with a minimum of 6 per cent. per annum. Applications for advances, accompanied by a banker's guarantee of sterling payment of the bill at maturity, were to receive preferential consideration.

In revised conditions subsequently issued in September, 1919, it was stated that advances (up to 80 per cent. of exporter's cost) would be made without recourse to the exporter (except in the case of misrepresentation by him), but would be a first charge upon the bill of exchange and relative security. Also that the department were prepared to consider such propositions for security as might be laid before them by the exporter.

By an Act passed on 9th August, 1920 (Overseas Trade (Credits and Insurance) Act, 10 & 11 Geo. V, c. 29), Parliament formally granted the Board of Trade power to accord credits under the Export Credits Scheme up to an aggregate amount at any time outstanding not exceeding £26,000,000.

On 25th October, 1920, it was announced that the department were authorized to advance, in approved cases, up to 100 per cent. of the cost of the goods to the exporter (including freight, insurance, and commission payable to the department), retaining recourse against the exporter in respect of 20 per cent.

The inclusion of wool tops, noils, and waste within the Export Credits Scheme was announced on 16th December, 1920.

In the House of Commons on 9th March, 1921, an announcement was made that in future the Government proposed, instead of advancing 100 per cent. of the cost of goods to the exporter in this country, to *guarantee* up to 85 per cent. of the invoice price (to the buyer) in cases where goods were not written up above the market value. The importer in the foreign country was to put up approved security to the extent of not less than 50 per cent., and the Government would then take one-half of the uncovered risk. If the importer put up 50 per cent. security, the Government would stand the risk of the exporter upon a further 25 per cent.; if the importer put up 60 per cent., the Government would take the risk on a further 20 per cent., and if the importer put up 70 per cent., the Government would take the risk on a further 15 per cent.,

giving the exporter in this case safety up to 85 per cent. If the importer put up 85 per cent. security, the Government undertook no risk, for 15 per cent. was the lowest risk the exporter must undertake.

Alternatively, the Government would guarantee 70 per cent. of the loss on any approved export transaction carried through by a bank in this country, the bank to arrange with the exporter their respective shares of the remaining risk.

It was also stated that it was intended to apply the scheme to trade with the Dominions, but that, for the time being, it would not cover export of raw materials.

Up to 6th December, 1920, the advances made by the Export Credits Department amounted only to about £120,000, and up to 9th March, 1921, to about £400,000. Such a total is admittedly extremely small and illustrates the remarkably small extent to which the Government scheme has been utilized by traders. Probably the main reason why the facilities have not been more availed of has been the lack of acceptable security in the ownership of would-be importers in the impoverished countries. A deposit of currency as security would, obviously, lock up liquid resources of the importer until such time as he received payment in his own country for the imported articles. As at present framed, the scheme is obviously inadequate to cope with the temporary paralysis that has overtaken international trading. To a very large extent this paralysis, as is pointed out elsewhere, is due to markets, at home and abroad, being stocked with high-priced goods, and reduced purchasing power of the general consumer.

Since December, 1920, however, it is gratifying to note, from the particulars given below, that some increased use has been made of the facilities afforded by the export credits scheme. The following return of advances made, applications sanctioned, and advances repaid, under the Overseas Trade (Credits and Insurance) Act, 1920, was published in the *Board of Trade Journal* dated 28th April, 1921—

ADVANCES ACTUALLY MADE

	£	s.	d.
1st January to 31st March, 1921, for Finland, Baltic Provinces, Poland, Czecho-Slovakia, Yugo-Slavia, Roumania, Bulgaria, and Austria	321,058	5	8
Total from September, 1919, to 31st March, 1921, for Finland, Baltic Provinces, Poland, Czecho-Slovakia, Yugo-Slavia, Roumania, Bulgaria, and Austria	458,843	1	8

Applications Sanctioned	£	s.	d.
1st January to 31st March, 1921	686,711	12	10
Total from September, 1919, to 31st March, 1921. .	2,086,745	17	10
Advances Repaid			
September, 1919, to 31st March, 1921	16,173	2	10

The Brussels International Financial Conference

On Friday, 24th September, 1920, after numerous postponements, there opened at Brussels an International Conference to discuss and to suggest, where possible, remedial measures for the many economic and financial evils the world is now suffering from as the aftermath of the recent war ; evils which, in the main, have arisen from the violation during and since the war of basic principles of economics and finance, in particular unprecedented inflation of credit and currency. As economic and financial conditions of different countries reflect themselves in the exchanges, the proceedings of this important Conference are therefore briefly reviewed in this chapter.

Prior to the opening of the Conference, which was attended by representatives of thirty-nine countries, a series of pamphlets was prepared, at the request of the League of Nations, by a number of eminent economists in various countries. These pamphlets, which included a mass of statistical matter, were prepared with a view to their serving as a preliminary to the Conference, and most of them dealt with monetary and currency problems which had arisen since the war. The pamphlets disclosing some differences of opinion, the chief writers, in order to facilitate the work of the Conference, met together and drew up a joint memorandum on those points in the economic and financial situation which they considered to be of supreme importance, and on which they were in complete harmony. A copy of this Memorandum is given below—

I.—Inflation

1. It is essential that the inflation of credit and currency should be stopped everywhere at the earliest possible moment.

2. To this end, Government spending must be cut down, the conduct of Government enterprise at less than cost and the payment of subsidies on particular commodities and services must, as far as possible, be abolished, and military and naval expenditure stringently restricted.

3. The equilibrium of State Budgets must be restored, loans not being employed to meet ordinary current requirements.

4. Artificially low Bank Rates out of conformity with the real scarcity of capital, and made possible only by the creation of new currency, must be avoided.

5. Floating debts should, as soon as practicable, be funded.

II.—Exchanges

6. The level of the exchanges tends to correspond with the relative internal values of the currencies of the several countries. The serious depression of certain exchanges beneath their real parities would be ameliorated by—

(a) The funding of floating debts held abroad in the form of notes.
(b) The restoration as soon and as far as practicable of normal trade intercourse between the different countries.

III.—International Credits

7. The grant of credit (whether through an international loan or system of guarantees to private lenders or otherwise) to distressed countries must naturally be conditioned upon some priority being given to these credits, and upon other claims being postponed till those credits have had time to exercise their influence upon production.

8. The grant of credits should be conditional—

(a) Upon their being used only for the most immediately remunerative purposes, including the provision of means of subsistence for the labouring population; and
(b) Upon the borrowing countries doing everything in their power to co-operate in the work of restoring economic life.

9. The capacity of the lending world to grant credits will depend, in great measure, upon the restoration of real peace and normal conditions of international trade.

(Signed) G. Bruins.
Gustav Cassel.
Charles Gide.
M. Pantaleoni.
A. C. Pigou.

It will be observed from the above Memorandum that it represents an exposition of certain elemental financial and economic principles, the real basis of the welfare of any State. In effect, the Memorandum states: "Reverse the processes that have given rise to the present economic and financial situation. Stop employing palliative measures, which can only make the situation still worse, and delay the eventual rehabilitation of the world." The principles on which the economic and financial recovery of all countries rest being so manifest, it was not to be expected that the Conference could do much more than reiterate them to the world. This was practically the net outcome of the Conference, which concluded its meetings on 8th October, 1920. No panacea was found for the world's economic evils, and all schemes for financial salvation based on further monetary inflation were rejected by the Conference.

The one practical suggestion submitted to the Conference was a scheme propounded by M. ter Meulen, a Dutch banker, for the

provision of credit for the nationals of impoverished countries. Briefly stated, under this plan it is suggested that an International Commission of bankers and business men, appointed by the Council of the League of Nations, should determine the amount of credit to be approved upon the security of specific assets assigned for the purpose by the Governments of countries desiring to participate in the scheme. Against these assets the Commission is to authorize the issue of gold bonds, to be lent to importers by their own Government in order that they may pledge them abroad as collateral security for importations. One objection to the scheme is that the exporter would lock up his own resources for the period of the credit, presumably for a period of one to three years, unless he could prevail upon a bank to accept the bonds as collateral for loans. In this event there would tend to take place further inflation and a consequent rise in prices in the country of the exporter. The above-named and other minor objections, however, must be waived if the adoption of the scheme will bring economic rehabilitation to the present impoverished countries. On 4th March, 1921, the League of Nations appointed Sir D. Drummond Fraser, K.B.E., a Manchester banker, to examine the assets the impoverished countries were prepared to offer as security, and to organize the ter Meulen scheme. His report has not been received up to the time of writing, but probably when issued will contain suggestions for extensions and modifications of the original proposals.

As already stated, the Conference opened on 24th September, 1920. Its earlier meetings were devoted to hearing an exposition of the financial situation of each of the thirty-nine countries represented, in order to obtain a complete understanding of the economic and financial problems to be considered. The Conference next divided the work involved in the examination of these problems into four parts, and entrusted special commissions of its members with the task of making a detailed study and preparing specific recommendations with regard to (*a*) public finance, (*b*) currency and exchange, (*c*) international trade and commerce, and (*d*) international action with special reference to credits. The various recommendations of these commissions were later unanimously approved by the Conference. Those proposed by the Commission on Currency and Exchange are given on the following page—

1. It is of the utmost importance that the growth of inflation should be stopped.

2. Governments must limit their expenditure to their revenue. (This resolution excepted the finance of reconstructing devastated areas.)

3. Banks, and especially banks of issue, should be freed from political pressure and should be conducted solely on the lines of prudent finance.

4. The creation of additional credit should cease and Governments and municipalities should not only not increase their floating debts, but should begin to repay or fund them by degrees. (In a reference to this resolution, the Commission stated: "In normal times the natural and most effective regulator of the volume and distribution of credit is the rate of interest which the central banks of issue are compelled, in self-preservation and in duty to the community, to raise when credit is unduly expanding.")

5. Until credit can be controlled by the normal influence of the rate of interest, it should only be granted for real economic needs.

6. Commerce should, as soon as possible, be freed from control, and impediments to international trade removed.

7. All superfluous expenditure should be avoided.

8. Without entering into the question whether gold is or is not the ideal common standard of value, we consider it most important that the world should have some common standard, and that, as gold is to-day the nominal standard of the civilized world, it is highly desirable that the countries which have lapsed from an effective gold standard should return thereto.

9. It is useless to attempt to fix the ratio of existing fiduciary currencies to their nominal gold value; as, unless the condition of the country concerned were sufficiently favourable to make the fixing of such ratio unnecessary, it could not be maintained.

10. Deflation, if and when undertaken, must be carried out gradually, and with great caution; otherwise the disturbance to trade and credit might prove disastrous.

11. We cannot recommend any attempt to stabilize the value of gold, and we gravely doubt whether such attempt could succeed.

12. We believe that neither an International Currency nor an International Unit of Account would serve any useful purpose or remove any of the difficulties from which International Exchange suffers to-day.

13. We can find no justification for supporting the idea that foreign holders of bank notes or bank balances should be treated differently from native holders.

14. In countries where there is no central bank of issue, one should be established.

15. Attempts to limit fluctuations in exchange by imposing control on exchange operations are futile and misleading.

Of the several resolutions proposed by the other three commissions the following two are worthy of particular notice—

The International Financial Conference affirms that the first condition for the resumption of international trade is the restoration of real peace, the conclusion of the wars which are still being waged, and the assured maintenance of peace for the future.

Whilst recognizing the practical difficulties in the way of immediate action in all cases, the Conference considers that every Government should abandon at the earliest practicable date all uneconomical and artificial measures which conceal from the people the true economic situation.

After the close of the Conference, a brief report[1] was published of the proceedings at the various meetings, including details of the scheme for international credits proposed by M. ter Meulen. At a later date, in February, 1921, there was issued a final report,[2] consisting of five large volumes, containing a verbatim record of the debates at the various meetings, the large amount of statistical data laid before the Conference by the representatives of the various countries, and other matter.

[1] Report and Resolutions of the International Financial Conference, held at Brussels, 24th September-8th October, 1920. Published for the League of Nations by Hodder & Stoughton, Limited, London.

[2] Proceedings of the International Financial Conference, Brussels, 1920, in three volumes, with two supplementary volumes, published for the League of Nations by Harrison & Sons, Limited, London.

CHAPTER XVI

FINANCIAL REPORTS ISSUED SINCE 1916

ONE of the indirect beneficial results of the recent war is that it compelled the Government to appoint at different times since 1916 Select Committees and other Committees to inquire into many financial matters and problems which were increasingly engaging public attention. The conclusions of the various Committees, after the examination of numerous expert witnesses, were later published in a series of reports which must ultimately be not only of historical interest but prove of material help to Committees appointed in the future to undertake various financial inquiries. Several of the reports issued since 1916 deal with the effects of unprecedented monetary inflation since 1914, and advance incontestible reasons for stopping further inflation and for effecting gradual deflation, as a preliminary to the restoration of sound financial conditions. Some of these reports are printed in full in the Appendix to this book; from others many extracts appear in several of the chapters. Brief comments on each are given below.

FINANCIAL FACILITIES FOR TRADE.

Report to the Board of Trade by the Committee appointed to investigate the question of financial facilities for Trade (*Cmd.* 8346). *Dated* 31*st August,* 1916.[1]

This report, which was published on 22nd September, 1916, set forth the recommendations of a Committee appointed by the Board of Trade "to consider the best means of meeting the needs of British firms after the war as regards financial facilities for trade, particularly with reference to the financing of large overseas contracts, and to prepare a detailed scheme for that purpose." The inquiry arose out of a statement of the President of the Board of Trade in the House of Commons to the effect that English banking had not been sufficiently adventurous in the past, and might with advantage be more enterprising in the future. The Committee, after pointing out the essential differences between

[1] For extracts from this report, see chapter entitled " The Banking Position, Section, The British Trade Bank or Corporation."

the English and German banking systems, but recognizing the immense aid the latter had been to German industry and manufactures, finally came to the conclusion that there was ample room in the British banking system for a new institution which, while not interfering unduly with the ordinary business done by the British Joint Stock Banks, by Colonial Banks, and by British-foreign Banks and banking houses, would be able to assist British interests in a manner that was not possible under existing conditions; particularly in furnishing long term credits and the finance of certain classes of overseas business. As a result of the recommendations of the Committee, there was later formed the British Trade Corporation. It is yet too early to state whether the facilities afforded by this institution will meet fully the recommendations and intentions of the Committee.

PREMIUM BONDS.

Report from the Select Committee on Premium Bonds (168). *Dated 16th January*, 1918.[1]

This Committee was appointed on 6th November, 1917, "to inquire into and report on the desirability or otherwise of raising money for the purpose of the war by the issue of Premium Bonds." For some months previous to its appointment, many opinions had been expressed in the House of Commons and in the Press to the effect that an issue of Premium Bonds would not only prove very popular with certain classes of the community, but would enable the Government to attract loans at a rate of interest materially less than the rate it was borrowing at in 1917. It was thought by the proposers of such an issue that many people would be prepared to make loans to the Government at a rate of interest as low as $2\frac{1}{2}$ per cent. if there was a possibility of their subsequently being the lucky holder of a drawn bond to which there was attached a large prize. It was also contended that the issue of Premium Bonds would lead to less extravagance, through the transfer of purchasing power by the working classes to the Government. Obviously, such a transfer would have had a beneficial effect on the economic position of the country at a time when war conditions demanded the greatest economy in consumption of goods and services by the

[1] For copy of Report see Appendix VIII.

general public. The Committee, after examination of thirty-five witnesses, representing various interests, produced a very inconclusive report, and candidly admitted that there was sharp division of opinion, not only amongst their members but also between the witnesses examined, as to the advisability or otherwise of an issue of Premium Bonds. The report was duly considered by the House of Commons, the members of which showed the same indecision or conflict of opinion as the Committee, the proposal, after several revivals, for the issue of Premium Bonds being finally rejected by the House on 1st December, 1919. It has, however, to be noted that in the War Loan of 1919, the possibility of receiving any year a reasonable premium was introduced into the terms under which the Victory Bonds were issued in connection with this loan. The subscription price was £85 per cent., and the holders of bonds that happen to be drawn each year will receive immediately £100, regardless of the current market price.

BANK AMALGAMATIONS.

Report of the Treasury Committee on Bank Amalgamations (Cmd. 9052). Dated 1st May, 1918.

The amalgamation movement of large banks that commenced in December, 1917, arousing fears in some quarters of the eventual establishment of a money trust, the Chancellor of the Exchequer, by a Minute dated 11th March, 1918, appointed a Treasury Committee "to consider and report to what extent, if at all, amalgamations between banks may affect prejudicially the interests of the industrial and mercantile community, and whether it is desirable that legislation should be introduced to prohibit such amalgamations or to provide safeguards under which they might continue to be permitted." In their report,[1] which was published on 21st May 1918, the Committee reviewed very fully the many objections of the commercial community to further amalgamations, and though expressing an opinion that they did not think there was any fear of a money trust being established in the near future, they recommended that the approval both of the Treasury and of the Board of Trade should be obtained to any further proposed combines, and that sanction should be refused if an amalgamation scheme

[1] For extracts from this report, see Chapter V, "The Banking Position, Section, The Amalgamation Movement."

involved an appreciable overlap of area without securing compensating facilities to the public, or would result in undue predominance on the part of the larger bank. The Committee recognized that the old type of amalgamation—the absorption of local banks by a larger and more widely-spread Joint Stock Bank—had conferred greater facilities on the public. The advantages or otherwise of the new type of amalgamation—the union of one large Joint Stock Bank with another similar bank—had yet to be proved by experience, and any such proposed amalgamation in the future should, therefore, receive careful consideration by disinterested parties before being permitted to take place.

FINANCIAL FACILITIES.

Report of the Committee on Financial Facilities (*Cmd.* 9227). *Dated* 21*st November*, 1918.[1]

This Committee was appointed by a Treasury Minute dated 26th November, 1917, "to consider and report whether the normal arrangements for the provision of financial facilities for trade by means of existing banking and other financial institutions will be adequate to meet the needs of British industry during the period immediately following the termination of the war, and, if not, by what emergency arrangement they should be supplemented, regard being had in particular to the special assistance which may be necessary—

(*a*) "To facilitate the conversion of works and factories now engaged upon war work to normal production ;

(*b*) "To meet the exceptional demands for raw materials arising from the depletion of stocks."

In order to facilitate their work the Committee divided their investigations into two main parts: (1) The financial needs of trade immediately after the war, and the respect in which these needs will differ from the needs under normal conditions ; (2) the provision of financial facilities to meet these needs. The report of the Committee was an exceedingly interesting document. In the first part the Committee reviewed at length the increased demands for capital that were likely to arise for a considerable period after the war owing to increased cost of labour and materials, the necessity for giving longer credit, anticipated expansion in the

[1] For copy of Report see Appendix IX.

volume of trade, repairs and replacements, re-conversion of plant and works from war requirements to peace-time production, and new requirements in respect of permanent outlay. The second part of the report gave a very interesting account of the credit and financial system ruling in this country before the war, the part dislocation and abuse of the normal credit machinery during the war, and emphasized the necessity for the re-establishment of a sound financial basis by the restoration of an effective gold standard as soon as possible. The Committee considered that the banks would be able and willing to meet a considerable part of the demands for increased liquid capital after the war, but would not be able to accede to requests for extended credit of any considerable magnitude involving a lock-up of funds for a long period, and therefore recommended that industrial concerns should themselves increase their financial resources by issues of new shares when possible.

CURRENCY AND FOREIGN EXCHANGES

First Interim Report of the Committee on Currency and Foreign Exchanges after the War (*Cmd.* 9182). *Dated* 15*th August*, 1918.

This Committee was appointed in January, 1918, by the Treasury and the Minister of Reconstruction "to consider the various problems which will arise in connection with currency and the foreign exchanges during the period of reconstruction, and report upon the steps required to bring about the restoration of normal conditions in due course." The following words were subsequently added to the Terms of Reference: "and to consider the working of the Bank Act, 1844, and the constitution and functions of the Bank of England with a view to recommending any alterations which may appear to them to be necessary or desirable."

A long interim report[1] of this Committee was published on 29th October, 1918, in which the Committee gave an excellent account of the currency system before the war and of the new conditions which had rendered the gold standard inoperative during the war. Clearly recognizing the cumulative evils of inflation of credit and currency, the Committee proclaimed it was imperative that after the war the conditions necessary to the maintenance of an effective gold standard should be restored without delay. With

[1] For copy of Report, see Appendix X.

this object in view, they recommended the cessation of Government borrowings and a reduction of the floating debt as soon as possible after the war, and the legal limitation of the fiduciary part of the Currency Note issue. The Committee did not see their way to suggest any alteration in the provisions of the Bank Act of 1844, nor in the form of the customary Weekly Return of the Bank of England, but they expressed the opinion that the provisions of Section 3 of the Currency and Bank Notes Act 1914, under which the Bank of England may, with the consent of the Treasury, temporarily issue its own notes in excess of the legal limit, should be continued in force, in order to avoid the risk of the possibility of the law having to be broken in times of crises, subject to indemnity from Parliament, in order to restore confidence. A recommendation by a number of bankers that banks should in future be required to publish a monthly statement in a certain prescribed form, showing the average of their weekly balance sheets during the month, received the support of the Committee. Apart from the two above suggestions the pith of the report may be said to have been recommendations for the institution of measures to again make the Bank Rate function as an effective controller of bank credit and the foreign exchanges, as in pre-war times, and as soon as practicable.

The Final Report (Cmd. 464). *Dated 3rd December,* 1919.

The final report[1] of the Committee on Currency and Foreign Exchanges after the war was published on 13th December, 1919. It affirmed the conclusions expressed in the interim report, and again referred to the necessity for increased production, cessation of Government borrowings, and decreased expenditure, both by the Government and by each individual member of the nation, as the first essentials to recovery. These, the report stated, must be associated with the restoration of the pre-war methods of controlling the currency and credit system of the country for the purpose of re-establishing at an early date a free market for gold in London. A hope was expressed that the Government would in future confine its use of Ways and Means Advances, obtained from the Bank of England, to providing for purely temporary necessities. The

[1] For copy of Report, see Appendix XI.

Committee considered that such advances afforded a legitimate method of tiding over a few weeks' shortage of funds by the Government, but were entirely unsuitable for borrowings over a longer period. In the matter of the Currency Note issue, the Committee considered that effect should at once be given to the recommendation made in their interim report that the actual maximum fiduciary circulation in any year should become the legal maximum for the following year. This latter recommendation the Treasury immediately put into force by a Minute dated 15th December, 1919, the maximum fiduciary issue of Currency Notes permissible for the year 1920 being declared to be £320,600,000.

Mobilization of Securities

Report of American Dollar Securities Committee (212). *Dated 4th June,* 1919.

This Committee was appointed by the Chancellor of the Exchequer at the end of December, 1915, "to control the operations of the Treasury undertaken for the purpose of carrying into effect the Government Scheme for the sale to, and deposit with, the Treasury of American Dollar Securities." An exceedingly interesting report[1] of the Committee, containing a full account of their operations, was published early in December, 1919.

Dormant Bank Balances

Report of the Select Committee on the Dormant Bank Balances and Unclaimed Securities Bill (233). *Dated 16th December,* 1919.

The nature of this report is indicated by the above title. The Committee inquired into, among other matters, the truth of statements that had been made by certain people that the banks had enormous amounts of unclaimed balances on their books (one estimate being as high as £100,000,000), and a great quantity of valuables and securities in their strong rooms which had been originally left for safe custody but never claimed by their owners. The evidence laid before the Committee definitely dispelled the correctness of these opinions. The Central Association of Bankers

[1] For extracts from this Report, see Chapter VI "Government Borrowings, Section, American Dollar Securities Committee."

furnished a statement, prepared as the result of inquiries among the banks of the United Kingdom, showing that—

The sum of balances dormant for six years prior to 1st January, 1920, on current accounts was	£2,220,926
The sum of balances dormant for six years prior to 1st January, 1920, on deposit accounts was	5,787,659
TOTAL	£8,008,585

It was estimated by the banks that £5,162,415 of the above total could not be regarded as permanently dormant, and that only £2,846,170 could be described as belonging to untraceable persons. This latter amount represents only about 0·1 per cent. of the total amount, namely, £2,399,000,000, standing to the credit of customers on 31st December, 1919.

With respect to boxes and parcels entrusted to banks for safe custody, the report stated the evidence showed that there was a very considerable quantity of such boxes and parcels, of which the contents were unknown, which were lying in the strong rooms of the banks. It was likely that many of these boxes and parcels were empty, having contained articles which had been withdrawn, the box being left with the bank from motives of convenience, or because the owner had intended at some future time to use the box afresh. Further, of the boxes and parcels which were not empty, it seemed probable that very many contained legal or financial documents which, by lapse of time, had ceased to have any value or interest. But when all these large deductions had been made, there was probably a small residuum of boxes and parcels of which the owners had been lost sight of and which contained articles of some value or papers of some interest.

DECIMAL COINAGE

Report of His Majesty's Commissioners appointed "to consider whether it is advisable to make any change in the denominations of the currency and money of account with a view of placing them on a decimal basis." (*Cmd.* 628.) *Dated 23rd February,* 1920.

At the commencement of this report it is pointed out that the question of the introduction of a decimal coinage had been before this country for more than a century, and that, though several Royal Commissions had been appointed at different times to

examine various proposals, no complete decimal coinage scheme had secured the recommendation of any Commission. The report briefly reviews the past proposals, considers the existing system and the advantages of a decimal system, but lays stress on the difficulties of the adoption of the pound and mil scheme. The Commission finally expressed the opinion that it was not advisable to make any change in the denomination of the currency and money of account of the United Kingdom with a view to placing them on a decimal basis. In support of this conclusion, the Commission gave the following considerations—

1. In any scheme for reducing the existing system to a decimal basis, the pound should be retained.
2. The pound and mil scheme is the only strongly supported scheme which complies with this condition.
3. The advantage to be gained by a change to the pound and mil scheme as regards keeping accounts is in no way commensurate with the loss of the convenience of the existing system for other purposes.
4. Grave difficulties will be created by the alteration of the penny.
5. The scheme cannot be tried as an experiment or on a voluntary basis.

Economic Conditions of the World

On 9th March, 1920, there was published a declaration[1] by the Supreme Council of the Peace Conference on the Economic Conditions of the World (Cmd. 646). This interesting document, which must prove of historical interest to future generations, not only reiterated the many arguments and conclusions to be found in the reports already reviewed of the Committee appointed to consider the subject of Currency and Foreign Exchanges after the War, but had something to say about the conditions ruling in the other belligerent countries. In brief, the declaration implored the world to work harder, to reduce current consumption, to stop inflation of credit and currency, to effect gradual deflation as soon as possible, and to supply necessary foodstuffs, raw materials, and other essential commodities to the impoverished countries on credit in order that they might gradually effect their own

[1] For copy of Declaration, see Appendix XII.

economic recovery. The declaration throughout proves that the Supreme Council clearly recognized the influences that contributed to the rise in prices, a passing reference being made to the elements of the equation of exchange. Particular stress was laid on the necessity for increased production and freedom in world-wide interchange of commodities, but no reference was made to the serious position that would be created, and the great amount of unemployment that would arise, when a severe fall in wholesale commodity prices took place and merchants and the retail trade were left with large stocks of high-priced goods. The human factor, the reluctance of the retail trade to cut losses and replenish their stocks at materially lower values, and thus quickly afford the general consumer the benefit of lower prices, was evidently overlooked by the Council. It is also doubtful if the Council recognized that the *total* productive capacity of the world had not been *greatly* reduced by the war, and that the restoration of capital plant and property in the devastated areas, under modern means of production, might be accomplished without any material diversion of labour from the production of commodities required for general consumption. The war debts (which the declaration stated were closely connected with inflation) are no measure of true economic losses caused by the war. On the subject of profiteering, the Supreme Council made the following statement: "Excessive profit making (commonly known as profiteering) has resulted from the scarcity of goods. Deflation and a check upon the continuous rise in prices will do much in itself to end the conditions that made profiteering possible. But it is essential, in order to obtain the co-operation of all classes in the increase of production, that each Government should take such steps as are appropriate to the circumstances of its own people to assure and guarantee to the workers that the burdens that they are called upon by their efforts to remedy are not aggravated by those who would exploit the economic difficulties of Europe for their own personal ends."

Increase of War Wealth

Report from the Select Committee on Increase of War Wealth (102). *Dated* 13*th May*, 1920.

This Committee was appointed "to inquire into the proposal

to impose a tax on War-time Increases of Wealth, and to report whether such a tax is practicable, and, if so, what form it should take." For some time previous to the appointment of the Committee, suggestions had been made in various quarters, particularly by Labour Members of the House of Commons, that part of the National Debt should be cancelled by a levy on additional wealth accumulated during the war. The difficulties of equitable assessment and methods of collection were, however, recognized as likely to prove great obstacles to the adoption of the proposal. The Committee, in their report, fully recognized such difficulties, but did not consider them insurmountable, suggesting equitable graduated rates, certain abatements, and deferred payments when necessary, if Parliament decided to impose a special tax for the purpose in view. As to the aggregate increase of war-time wealth, the report quoted an estimate prepared by the Board of Inland Revenue that the aggregate of individual increases of wealth between 30th June, 1914, and 30th June, 1919—a period of five years—was £4,180,000,000, and that, if the increases in the hands of those persons whose post-war wealth did not exceed £5,000 was excluded, there remained an aggregate increase of £2,846,000,000 in the hands of 340,000 persons. Under the scale considered by the Committee, it was estimated that the levy would be payable by about 75,000 individuals, and that the yield would be about £500,000,000.

As regards the effect of the imposition of the tax on the individual taxpayer, and on the country at large, the report states the Committee found that—

"(a) The representatives of commercial and financial interests were convinced that the imposition of a tax on war-time wealth would have dire results. In their view such a tax would lead to a general shrinkage of credit, to a fall in the prices of securities and a rise in the rate of interest. They feared that traders would withdraw from business, that advances made to traders by their bankers would be called in, that exports would be curtailed, and that unemployment, panic, and disaster would ensue. One and all, they were of opinion that reduction of debt should be secured by taxation of current profits and current income and not by any levy on capital, however limited in extent. . . .

"(b) On the other hand, the economists who came before your

Committee disagreed with many of these conclusions. They contended that the imposition of such a tax could not diminish the wealth of the country, expressed in terms of things, and that in so far as taxpayers were impelled to reduce their expenditure in order to meet their liability to the tax, the actual capital resources of the country would be improved. If there were any general disturbance of credit and finance, such effect must, they considered, be purely temporary, while in so far as the tax was applied to the reduction of floating debt, a reduction in the price of commodities should result.

"(*c*) The Board of Inland Revenue for their part pointed out that the main part of the industry of the country is in the hands of public companies and that these concerns would not be directly affected, any tax on the increased value of the shares being paid by the individual shareholders."

After a close examination and consideration of the evidence, for and against the proposed tax, the Committee formulated the following main conclusions—

They are of opinion that, although the administration of a tax of this character would involve many difficulties, yet those difficulties should not be insurmountable, and, in its main features, the scheme of the Board of Inland Revenue, as now amended, is practicable in an administrative sense.

The effect of the large abatements now proposed is that the burden of taxation would, in the main, be cast only upon those individuals who could most justly be called upon to make the sacrifice and that the tax would discriminate against those who had made exceptional profits in consequence of the war conditions.

As regards the question of practicability in its wider sense of expedience and desirability, your Committee feel that this question is one which can only be determined with regard to national and financial conditions in general.

If the financial position of the country is such that it becomes a matter of urgent necessity to raise a sum of the magnitude of £500,000,000, which cannot be obtained by other means, the objections raised against a tax of this character should not be allowed to stand in the way of the imposition of such a tax to meet the national emergency. Moreover, although the suggested tax is strongly opposed by the financial and commercial world, there is,

on the other hand, a very large body of public opinion which regards it not only as expedient but as a just and necessary attempt to equalize the losses suffered during the war.

Whether in the present financial position a tax of this description is desirable or expedient as an alternative to Excess Profits Duty, or to the taxation of profits in any other form, is a matter on which your Committee feel that it is not within their province to pronounce an opinion, and they must therefore leave that question to the decision of the House of Commons.

From the above extracts from the report it is obvious that, though the Committee considered a tax on war-time increases of wealth practicable, notwithstanding such a levy would present difficulties in equitable collection, they did not definitely recommend its imposition, preferring to leave the decision to the House of Commons. On 7th June, 1920, the Chancellor of the Exchequer stated in the House of Commons that the Government had definitely abandoned the proposal for a levy on war-time increase in wealth, this decision being based on various reasons, one of which was the dislocation and uncertainty to industry and finance that would arise during the long process of valuation of such increase before the actual imposition of the tax.

Full detailed particulars of the basis of the Board of Inland Revenue estimate of £4,180,000,000, representing the aggregate of individual increases of wealth for the whole population of the United Kingdom during the five years ending 30th June, 1919, were given in a Memorandum (Cmd. 594) submitted to the Committee by the Board. The valuation was necessarily based on rough data. An estimate derived by adding to the increase in the National Debt the increase in Joint Stock Bank deposits, and subtracting the following items—external debt, sales of foreign investments, increase in investments (including Treasury Bills) held by banks, would make the war-time increase in wealth to be, roughly, £5,500,000,000. But there are certain other items to be taken into the calculation, such as depreciation in market values of securities, allowances for neglected repairs and necessary renewals, appreciation in value of property, value of new buildings and plant erected during the war, rise in market value of stocks of materials and finished goods, and adjustments for Excess Profits Duty liabilities, for none of which items can correct allowances be made

in the absence of data on which to base valuations. Again, it is an open question whether any allowance should be made for a temporary fall in investment values until actual sale by holders.

Accepting the Board of Inland Revenue estimate of £4,180,000,000, or annual average increase of £836,000,000, the reason why this amount is considerably greater than the rate of national savings immediately before the recent war, namely, about £350,000,000 per annum, is that the great Government demand for goods and services for the prosecution of the war, and inflation, enabled manufacturers, traders, and others to extract inordinate profits, notwithstanding greatly increased taxation.

CURRENCY EXPANSION, PRICE MOVEMENTS, ETC.

Statements of Currency Expansion, Price Movements, and Production in certain countries (*Cmd.* 734, *in continuation of Cmd.* 434). *Dated* 29*th May*, 1920.

These statements were prepared by the Board of Trade and show for various countries, since 1913, expansion in currency, comparison of expansion in currency with rise in prices and with rates of exchange on London, change in quantity of production of certain commodities, and index numbers representing prices.

BRUSSELS INTERNATIONAL FINANCIAL CONFERENCE.

Full particulars of the proceedings of this Conference, which opened on 24th September, 1920, and concluded its meetings on 8th October, 1920, are given in Chapter XV, reviewing the course of the Foreign Exchanges since 1914.

SUPREME ECONOMIC COUNCIL—BULLETIN OF STATISTICS.

Since 1919 a bi-monthly series of pamphlets have been issued by the Supreme Economic Council showing, mainly in the form of tables of statistics, the economic and financial progress or otherwise of certain countries.

CHAPTER XVII

A CRITICISM OF THE ECONOMIC AND FINANCIAL POLICY PURSUED BY THE GOVERNMENT DURING THE WAR

By A. H. Gibson

THE enormous increase of about £7,200,000,000 in the National Debt, as a consequence of the recent war, raises the important question whether a large part of such increase could not have been avoided by the Government adopting a different economic and financial policy during the war than was actually put in operation, and yet the war have been brought to a successful conclusion by Great Britain and her Allies. Reasons for thinking this opinion to be correct are set out below—

IF A DIFFERENT ECONOMIC POLICY HAD BEEN ADOPTED ?

If the Government had, early in the war, conscripted the factors of production necessary for the prosecution of hostilities, making the existing owners " Captains, Colonels, and Generals of Industry," with salaries fixed on a scale varying with degree of responsibility, paying reasonable wages to labour, and, in the case of companies, restricted profits and dividends, Government expenditure during the war would probably not have been more than 50 per cent. of its actual amount. Equality of sacrifice is admittedly impossible during war time, but general national service has never been an impossibility. If it be the duty of men of military age, as it undoubtedly is, to go forth to fight for the preservation of a nation's ideals and the defence of its lands and homes, surely it is an equal duty—nay, a greater one, for it is free from bodily danger—for the remainder of the community to provide, collectively, the fighting forces with food, clothing, and the necessary materials for fighting, without any material profit. With a National Debt, or mortgage on the community, in the neighbourhood of £7,800,000,000 at 31st March, 1920, future historians may well ask where was Great Britain's sense of equity and proportion during the war. Justice to the fighting forces demands that in war time there shall

be reduced civilian consumption and increased production and services, the saving in consumption and the extra production and services being a free gift to the State for war purposes. Modern warfare, as was amply proved during the recent war, is much more a trial of strength between the material resources at the command of the belligerent nations than between the numbers of men available for fighting. In the event of another great war in the future, conscription will probably be equally applied to every male member of the State, whether for productive services or fighting purposes. Surely, if in war time the right of the State be recognized to conscript the physical strength of certain male members of the community, and to forbid or restrict increases in rent, equity demands that the control of the factors of production should also temporarily pass to the State, until the conclusion of peace.

During the recent war there were particularly strong reasons for producers and manufacturers giving their services free to the State for the period of the war (subject to a sufficient living allowance being made in cases of proved necessity), for if men had not been sent to France to fight, and to man the Navy, the enemy would undoubtedly have invaded England and destroyed or taken possession of a large number of the mills and factories, and of stores of materials and finished goods found in the country. For this reason it appears particularly iniquitous that so many people should have been placed in a position during the war to amass considerable fortunes, whilst others were fighting and losing their lives for them and the country on the battlefields of Europe, and others came back home maimed and broken in health. By far the greater amount of the extra profits made during the war was due to the rise in prices occasioned by scarcity and inflation, and not to extra efforts by producers, manufacturers, and traders. During a period of rapidly increasing prices, due to war conditions and inflation, owners of the factors of production are placed in a position to extract a large "unearned increment" of profits from the community. Some people have been frank enough to admit that they could not help making large profits during the war, for stocks were continuously increasing in value simply by the act of holding for a period. It is true the Government obtained a return of some part of such "unearned increment" through the imposition of the Excess Profits Duty, but this tax, though well-intentioned in

its object, was vicious in its unexpected results, for it not only caused a further rise in prices, through being largely passed on to the consumer, but it led to extravagance in many ways, and at a time when war conditions demanded the greatest economy in consumption. If the Excess Profits Duty had been made 100 per cent. it would have had less effect on prices than it actually had at lower percentages. So long as manufacturers and traders were permitted to retain some percentage part of excess profits, they had naturally a powerful incentive to extract the greatest profits possible from the public, which they were able to do in consequence of demand ever tending to be greater than supply under the abnormal conditions created by the war.

In view of the foregoing considerations, it is a matter for regret that Parliament, after the issue on 13th May, 1920, of the Report of the Select Committee appointed to inquire whether a tax was practicable or not on war-time increases of wealth, decided against such a levy for various reasons. During the period of valuation of war-time increases in wealth for the purposes of a levy there would admittedly be some disturbance of credit conditions, but this would be more than compensated for later by quicker economic recovery of the country. As to the actual amount of war-time increases of wealth in the case of individuals in the United Kingdom, the Board of Inland Revenue estimated the net amount[1] at £4,180,000,000 between 30th June, 1914, and 30th June, 1919. Dr. Stamp's estimate[2] was £5,300,000,000, and with this latter estimate the writer agrees, but on a basis of calculation somewhat different to that adopted by Dr. Stamp. What the total increase amounts to at the present time it is not possible to state without a further estimate being prepared by the Board of Inland Revenue. Manufacturers and traders are known to have experienced considerable losses since the fall in prices commenced in April, 1920, but such losses, *as a whole,* are probably more than covered by the great profits made during the nine months July, 1919–March, 1920, which was a period of rapidly rising prices.

[1] The net amount represents the estimated aggregate increases of value appertaining to those individuals whose capital wealth increased in value during the war, *diminished* by the fall in value of the capital of those whose capital wealth decreased.

[2] Dr. Stamp's estimate was made before the Armistice and was directed to some indeterminate date just after the termination of the war.

If a Different Financial Policy had been Adopted ?

It is shown elsewhere in this book, particularly in the chapters on Prices, that the most vicious part of the financial policy of the British Government during the recent war was the creation of an excessive amount of credit inflation. When the Exchequer receipts from taxation and loans from the public were insufficient to meet Government expenditure, recourse was made to the banks to fill the gap by book entry credits. For this purpose, between £500,000,000 and £600,000,000 was credited to the Government by the banks. The excessive expansion of credit during the war, not warranted by economic conditions, created artificial prosperity. It permitted requests for higher wages to be conceded. Indirectly, it was the cause of the greater part of the rise in prices. It enabled manufacturers and traders to extract large profits from the Government and from the general consumer, and it later led, after the Armistice, to considerable further credit expansion by the banks. Manufacturers and traders informed the banks, in particular after the Armistice, that on account of the great rise in prices, they required considerably more credit to run their businesses. This was true, and the greater part of such requests were conceded by the banks by creating further book entries of credit to the extent of between £400,000,000 and £500,000,000 up to the end of 1919, or of between £600,000,000 and £700,000,000 up to the end of 1920. And so the snowball of inflation rolled on and expanded.

If the Government had not embarked upon the policy of credit expansion to pay for some of the goods and services it required for the prosecution of the war, the total cost of the war would probably not have exceeded from one-third to one-half of the actual cost, and notwithstanding it did not conscript industry. Each dose of inflation caused prices to rise still further, not only against the general consumer but also against the Government—the greatest purchaser. If no material inflation had taken place, there is reason to believe that the necessary war expenditure could have been met by receipts from taxation and the proceeds of War Loans subscribed for by the general public. Even the institution of a compulsory form of subscription to War Loans would have been greatly preferable to the policy of financing part of the cost of the war by book-entry bank credits. Whatever the amount of

bank credit the Government obtained during the war, the rise in prices that in consequence followed its disbursement must have ultimately cost the Government, in its expenditure for war stores, twice or thrice the amount of such credit. The effects of inflation are cumulative and far-reaching. It is becoming increasingly obvious to all observers that the country is going to pay a very heavy penalty for the inflation effects of the creation of large amounts of additional purchasing power since 1915, which, in the main, could have been avoided if the Government had adopted a saner financial policy during the conduct of the war. It is very easy to ignore basic financial and economic principles when the balloon of inflation is expanding, but when the bursting point comes, it is impossible to avoid trade being strangled by the strings and folds of the wrecked envelope. The growing volume of unemployment since the inevitable reaction in prices, with all its attendant grave possibilities, is one of the fruits of the policy of inflation embarked upon during the war, not only in this country but also abroad. Inflation which must eventually lead to a prolonged period of unemployment is little short of a crime when the world is wanting goods at a price it can afford to pay for them. Unemployment at any time is a waste of potential energy, which ought to be absorbed in augmenting the factors of production to meet future increased demand, if costs of extensions could be kept low enough.

Probably no better illustration of reaping the inflation harvest can be given than the following comment on the general economic position, extracted from the March, 1921, number of the *Monthly Bulletin of Statistics*, issued by the Supreme Economic Council.

> The most recent statistics available afford some indication of the seriousness of the industrial depression prevailing throughout the world. The production of such important commodities as coal, pig iron, crude steel, and sugar are considerably below the quantities available in the year 1913. Shipbuilding is stagnant. Imports and exports, measured by value, show a declining tendency. Orders are held back in view of the present high prices and in anticipation of material reductions in the near future. The fall in freights and the decline in cargo offering have caused shipowners to lay up many vessels. In most countries the amount of paper money in circulation has undergone but little reduction. Unemployment is serious in extent and in magnitude, and appears to be increasing. Wage reductions and the working of short time are reducing the purchasing power of the people in many countries.

Though labour has hitherto been lamentably blind to its own interests by intentionally, through ignorance, restricting production

in the past, in the belief that the less each member produced, the more work and better pay there would be for all, yet during the present period of severe trade depression, which is mainly the result of excessive world-wide inflation of credit and currency, a considerable amount of sympathy is surely due to the willing would-be workers of the unemployed. That inflation would eventually lead to grave social disturbances during the inevitable reaction in prices was obvious to all economists. To minimize the extent of such disturbances in the future, it is desirable that wage reductions should lag behind reductions in the cost of living, if such a course of action can be adopted without unduly imperilling the industry of the country through lesser costs of production abroad. From an economic standpoint, subsidies are vicious, but their continuance, to some extent, may be the lesser of two evils during the transition period.

Whether the war could have been brought to a successful conclusion by Great Britain and her Allies without any expansion of credit must necessarily be a matter for individual opinion. The greatly increased prices of essential imports doubtless necessitated some degree of inflation in the absence of reduced civilian consumption of commodities, and a greater volume of manufactured goods being available for export. On behalf of the Government it may be said that the conditions at the commencement of the war rendered it imperative that there should be immediate and considerable expansion in production. Moreover, it has to be recognized that the change-over of industry from peace time production to war production required a certain amount of time for the transition to be effected. The bribe of higher wages and higher profits in the early stages of the war was therefore probably essential to ensure immediate increased production. But, after the first year of the war, it should have been possible to set a limit to wages and profits, in other words, to, more or less, conscript industry for the remainder of the duration of the war. The Government was compelled to apply the principle of conscription to men required for the fighting forces and for performing services accessory to fighting, after the voluntary system had failed to supply the required numbers. It is certain that the adoption of the policy of inflation as a part means of financing the war has caused far greater evils than any disturbance that would have arisen due to temporary opposition

to the application of the principle of conscription to the factors of production for the period of the war, and to compulsory loans to the Government if found necessary. The fact that other combatant nations paid for a large part of the immediate cost of the war by heavily mortgaging posterity is no excuse for Great Britain having adopted the same policy and caused an inequitable redistribution of the national income.

One of the effects of inflation, which very few people have observed, was to cause a large transference of purchasing power from deposit to current accounts at the banks, and hence to dry up a main source of supply from which a large part of subscriptions to War Loans was necessarily derived. This is one of the reasons why it became increasingly difficult to raise large Government loans towards the end of the war and afterwards, notwithstanding successive rises in the rate of interest. Manufacturers and traders with considerably increased balances at their banks—the result largely of greater profits due to inflation—when asked to make large subscriptions to new War Loans, in many cases replied that they required the increased balances to run their businesses on account of the great rise in prices, in other words, that trade required more liquid capital to finance it, on account of the rise in prices, than it did before the war.

Taking all things into consideration, it is extremely doubtful if any country has gained anything by adopting a policy of inflation of credit during the war. Any advantages temporarily gained are not very clear, but the evil results of such a policy, and the aftermath yet to be reaped, are abundantly manifest already. England, with her great dependence on her export trade, was certainly the last country that should have embarked upon a policy of excessive inflation.

How long it will be before the evil effects of inflation have spent themselves is exceedingly difficult to estimate. Retail prices and costs of production must first fall to a level at which demand will increase to such an extent as to cause the re-employment on full time of those now thrown out of work as one of the penalties, foreseen by economists, of unprecedented inflation.

The restoration of the gold standard throughout the chief countries of the world appears unlikely to take place at an early date, and cannot be expected until the exchanges approach gold

parity. It is a matter for serious consideration whether the eventual rehabilitation of economic and financial conditions throughout the world might not be accelerated by the issue of a limited amount of international legal tender bonds, to form the basis of bank cash reserves and cover for internal currency. Any such issue would have to be carefully regulated by the rate of interest charged to approved applicants for the bonds, and the outstanding amount gradually reduced as improvement in economic conditions caused prices slowly to fall to an agreed upon world-wide index number. It would also be necessary to prohibit the issue of such bonds to any country that did not promise to effect gradual credit deflation within its own boundaries, otherwise there would be a tendency for further inflation. The eventual disposal of the interest received from the issue of the bonds would be a matter for consideration. It might, for the present, form an insurance fund to cover any ultimate losses arising out of permitting the smaller impoverished countries to participate in the scheme. The gold standard is not absolutely essential under modern conditions of banking and credit, but it proved in pre-war times the only brake on countries over-trading and an undue expansion of credit. The permanent issue of any paper substitute must necessarily be carefully regulated by a charge of a variable rate of interest, dependent on the course of an agreed upon world-wide index number.

The Multiplicity of Loans

When one analyses the war finance of Great Britain since the commencement of the war, one is struck by the variety of forms of borrowing, and the immense amount of clerical labour and of stationery that has been used in the issue of the loans and will still be required in the future management of the loans. The greater part of the clerical labour and stationery could have been avoided if the Government had made use of a pass-book system for the collection of loans. It would have been a very simple matter for every bank to keep a special War Loan Ledger, and to receive periodically from the Paymaster-General one cheque for payment of interest on War Loan accounts. The present coupon system entails an enormous amount of labour on the banks. The

crediting of interest to accounts is comparatively a very small matter. The day-to-day system of borrowing, which was eventually adopted by the Government, and which proved very successful, was suggested by the writer in 1915 in letters to the Press and to the Treasury.

APPENDICES

APPENDIX I

THE GENERAL MORATORIUM

A.—POSTPONEMENT OF PAYMENTS ACT, 1914. (4 & 5, Geo. 5. Ch. 11.)

An Act to authorize His Majesty by Proclamation to suspend temporarily the payment of Bills of Exchange and payments in pursuance of other obligations. (3rd August, 1914.)

BE it enacted by the King's Most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

1. (1) His Majesty may by Proclamation authorize the postponement of the payment of any bill of exchange, or of any negotiable instrument, or any other payment in pursuance of any contract, to such extent, for such time, and subject to such conditions or other provisions as may be specified in the Proclamation.

(2) No additional stamp duty shall be payable in respect of any instrument as a consequence of any postponement of payment in pursuance of a proclamation under this Act unless the proclamation otherwise directs.

(3) Any such proclamation may be varied, extended, or revoked by any subsequent proclamation, and separate proclamations may be made dealing with separate subjects.

(4) The proclamation dated the third day of August, nineteen hundred and fourteen, relating to the postponement of payment of certain bills of exchange is hereby confirmed and shall be deemed to have been made under this Act.

2. (1) This Act may be cited as the Postponement of Payments Act, 1914.

(2) This Act shall remain in force for a period of six months from the date of the passing thereof.

B.—PROCLAMATION OF 6TH AUGUST, 1914.

For Extending the Postponement of Payments allowed to be made by the Proclamation of the 2nd August, 1914, *to certain other Payments.*

GEORGE R.I.

WHEREAS under the Postponement of Payments Act, 1914, His Majesty has power by Proclamation to authorize the postponement of the payment of any bill of exchange or of any negotiable instrument or of any other payment in pursuance of any contract to such extent for such time and subject to such conditions or other provisions as may be specified in the Proclamation :

And whereas it is expedient that provision should be made for the purpose of such postponement of payment in addition to the provision already made by Our Proclamation, dated the second day of August, nineteen hundred and fourteen, relating to the postponement of payment of certain bills of exchange.

Now, therefore, We have thought fit, by and with the advice of our Privy Council, to issue this Our Royal Proclamation, and We do hereby proclaim, direct, and ordain as follows—

Save as hereinafter provided, all payments which have become due and payable before the date of this Proclamation, or which will become due and payable on any day before the beginning of the Fourth day of September, nineteen hundred and fourteen, in respect of any bill of exchange (being a cheque or bill on demand) which was drawn before the beginning of the

Fourth day of August, nineteen hundred and fourteen, or in respect of any negotiable instrument (not being a bill of exchange) dated before that time, or in respect of any contract made before that time, shall be deemed to be due and payable on a day one calendar month after the day on which the payment originally became due and payable, or on the Fourth day of September, nineteen hundred and fourteen, whichever is the later date, instead of on the day on which the payment originally became due; but payments so postponed shall, if not otherwise carrying interest, and if specific demand is made for payment and payment is refused, carry interest until payment as from the Fourth day of August, nineteen hundred and fourteen, if they become due and payable before that day, and as from the date on which they become due and payable if they become due and payable on or after that date, at the Bank of England rate current on the Seventh day of August, nineteen hundred and fourteen; but nothing in this Proclamation shall prevent payments being made before the expiration of the month for which they are so postponed.

This proclamation shall not apply to—

(1) any payment in respect of wages or salary;

(2) any payment in respect of a liability which when incurred did not exceed five pounds in amount;

(3) any payment in respect of rates or taxes;

(4) any payment in respect of maritime freight;

(5) any payment in respect of any debt from any person resident outside the British Islands, or from any firm, company, or institution whose principal place of business is outside the British Islands, not being a debt incurred in the British Islands by a person, firm, company, or institution having a business establishment or branch business establishment in the British Islands;

(6) any payment in respect of any dividend or interest payable in respect of any stocks, funds, or securities (other than real or heritable securities in which trustees, are, under Section One of the Trustee Act, 1893, or any other Act for the time being in force, authorized to invest);

(7) any liability of a bank of issue in respect of bank notes issued by that bank;

(8) any payment to be made by or on behalf of His Majesty or any Government Department, including the payment of old age pensions;

(9) any payment to be made by any person or society in pursuance of the National Insurance Act, 1911, or any Act amending that Act (whether in the nature of contributions, benefits, or otherwise);

(10) any payment under the Workmen's Compensation Act, 1906, or any Act amending the same;

(11) any payment in respect of the withdrawal of a deposit by a depositor in a trustee savings bank.

Nothing in this Proclamation shall affect any bills of exchange to which Our Proclamation dated the Second day of August, nineteen hundred and fourteen, relating to the postponement of certain bills of exchange applies.

God Save the King

C.—Proclamation of 12th August, 1914.

For Postponement of Payments.

George R.I.

Whereas it is expedient to extend Our Proclamation, dated the sixth day of August, nineteen hundred and fourteen (relating to the postponement of payments), so as to cover bills of exchange under certain circumstances, and also payments in respect of any debt from any bank whose principal place of business is in any part of His Majesty's Dominions or any British Protectorate:

Now, therefore, We have thought fit, by and with the advice of Our Privy Council, to issue this Our Royal Proclamation, and We do hereby proclaim, direct, and ordain as follows—

Notwithstanding anything contained in the said Proclamation, dated the Sixth day of August, nineteen hundred and fourteen (relating to the postponement of payments), that Proclamation shall apply, and shall be deemed always to have applied—

(a) to any bill of exchange which has not been re-accepted under Our Proclamation, dated the Second day of August, nineteen hundred and fourteen, as it applies to a bill of exchange, being a cheque or bill on demand, unless on the presentation of the bill the acceptor has expressly refused re-acceptance thereof, but with the substitution, as respects rate of interest, of the date of the presentation of the bill for the Seventh day of August, nineteen hundred and fourteen; and

(b) also to payments in respect of any debt from any bank whose principal place of business is in any part of His Majesty's Dominions or any British Protectorate, although the debt was not incurred in the British Islands and the bank had not a business establishment or branch business establishment in the British Islands.

Given at Our Court at Buckingham Palace, this Twelfth day of August, in the year of our Lord One thousand nine hundred and fourteen, and in the Fifth year of Our Reign.

God Save the King

D.—Proclamation of 3rd September, 1914.

Varying the Proclamations in respect of the Postponement of Payments dated respectively the Second day of August, the Sixth day of August, and the Twelfth day of August, and revoking the Proclamation dated the First day of September, Nineteen hundred and fourteen.

George R.I.

Whereas under the Postponement of Payments Act, 1914, We have power, by Proclamation, to authorize the postponement of the payment of any bill of exchange, or of any negotiable instrument, or any other payment in pursuance of any contract, to such extent, and for such time, and subject to such conditions or other provisions as may be specified in the Proclamation—

And whereas, in pursuance of that power, We have issued Proclamations in relation to the postponement of payments due before We were in a state of war or due in respect of contracts made before that time, dated the Sixth day of August, and the Twelfth day of August, nineteen hundred and fourteen; and on the Second day of August, nineteen hundred and fourteen, We also issued a Proclamation which is confirmed by the said Postponement of Payments Act, 1914, and is deemed to have been issued under that Act:

And whereas, under the said Act, We have power to vary, extend, or revoke any Proclamation under that Act by a subsequent Proclamation:

And whereas, it is desirable in the best interests of Our Realm at the present juncture that all persons who can discharge their liabilities should do so without delay, but it is at the same time for certain purposes expedient that Our said Proclamations should be varied, and for that purpose We issued a Proclamation dated the First day of September, nineteen hundred and fourteen:

And whereas it is expedient to revoke the last-mentioned Proclamation and to substitute therefor such variations of Our other Proclamations as are hereinafter set forth:

Now, therefore, We have thought fit, by and with the advice of Our Privy Council, to issue this Our Royal Proclamation, and We do hereby proclaim, direct, and ordain as follows—

1. If on the presentation for payment of a bill of exchange which has before the Fourth day of September, nineteen hundred and fourteen, been re-accepted under the terms of Our said Proclamation, dated the Second day of August, nineteen hundred and fourteen, the bill is not paid, then, the said Proclamation shall, in its application to that bill, have effect as if the period of two calendar months had been in the Proclamation substituted for the period of one calendar month, and the sum mentioned in the form of re-acceptance under the said Proclamation shall be deemed to be increased by the amount of interest on the original amount of the bill for one calendar month calculated at the Bank of England rate current on the date when the bill is so presented for payment as aforesaid.

2. Our said Proclamation, dated the Sixth day of August, nineteen hundred and fourteen, as extended by Our said Proclamation, dated the Twelfth day of August, nineteen hundred and fourteen, shall apply to payments which become due and payable on or after the Fourth day of September and before the Fourth day of October, nineteen hundred and fourteen (whether they become so due and payable by virtue of the said Proclamations or otherwise) in like manner as it applies to payments which become due and payable after the date of the said first mentioned Proclamation and before the beginning of the Fourth day of September, nineteen hundred and fourteen.

3. Nothing in this Proclamation shall affect the payment of interest under the Proclamations extended thereby, or prevent payments being made before the expiration of the period for which they are postponed.

4. Our said Proclamation, dated the First day of September, nineteen hundred and fourteen, is hereby revoked.

God Save the King

E.—PROCLAMATION OF 30TH SEPTEMBER, 1914.

Varying the Proclamations in respect of the Postponement of Payments, dated respectively the Second August, Sixth August, Twelfth August, and Third September, nineteen hundred and fourteen.

GEORGE R.I.

WHEREAS under the Postponement of Payments Act, 1914, We have power by Proclamation to authorize the postponement of the payment of any bill of exchange or of any negotiable instrument or any other payment in pursuance of any contract to such extent and for such time and subject to such conditions or other provisions as may be specified in the Proclamation:

And whereas in pursuance of that power We have issued Proclamations in relation to the postponement of payments due before We were in a state of war or due in respect of contracts made before that time, dated the Sixth day of August, the Twelfth day of August, and the Third day of September, nineteen hundred and fourteen (which are respectively referred to in this Proclamation as the first, second, and third General Proclamation), and on the Second day of August, nineteen hundred and fourteen, We also issued a Proclamation which is confirmed by the said Postponement of Payments Act, 1914, and is deemed to have been issued under that Act and is referred to in this Proclamation as the Bills (Re-acceptance) Proclamation:

And whereas under the Postponement of Payments Act, 1914, We have power to vary, extend, or revoke any Proclamation under that Act by a subsequent Proclamation:

And whereas it is desirable in the best interests of Our Realm at the present juncture that all persons who can discharge their liabilities should do so without delay, but it is at the same time expedient for the benefit of persons who cannot so discharge their liabilities that a further limited and final extension of the postponement of payment authorized by the said Proclamations should be made—

Now, therefore, We have thought fit by and with the advice of Our Privy Council to issue this Our Royal Proclamation, and We do hereby proclaim, direct, and ordain as follows—

1. The first General Proclamation as extended by paragraph (*b*) of the Second General Proclamation shall, subject to the limitations of this Proclamation, apply to payments which become due and payable on or after the Fourth day of October and before the Fourth day of November, nineteen hundred and fourteen (whether they so become due and payable by virtue of the said Proclamations or the Third General Proclamation or otherwise), in like manner as it applies to payments which became due and payable after the date of the first General Proclamation and before the beginning of the Fourth day of September, nineteen hundred and fourteen.

Provided that, if the payment is one the date whereof has been postponed by virtue of any of the said General Proclamations, and is one which carries interest either by virtue of the terms of the contract or instrument under which it is due and payable or by virtue of the said General Proclamations, then the person from whom the payment is due shall not be entitled to claim the benefit of this Article unless, within three days after the date to which the payment has been postponed by virtue of the said General Proclamations, all interest thereon up to that date is paid.

This Article shall not apply to—

(*a*) Any payment in respect of rent;

(*b*) Any payment due and payable to or by a retail trader in respect of his business as such trader.

2. The Bills (Re-acceptance) Proclamation shall continue to apply to bills of exchange (other than cheques and bills on demand) accepted before the beginning of the Fourth day of August, nineteen hundred and fourteen, the date of the original maturity whereof is after the Third day of October.

If on the presentation for payment of any such bill, the bill is not paid and is not re-accepted under the said Proclamation, then, unless on such presentation the acceptor has expressly refused re-acceptance thereof, the bill shall for all purposes, including the liability of any drawer and indorser, or any other party thereto, be deemed to be due and payable on a date one calendar month after the date of its original maturity instead of on the date of its original maturity, and to be a bill for the original amount thereof increased by the amount of interest thereon, calculated from the date of the original maturity to the date of payment at the Bank of England rate current on the date of its original maturity, and paragraph (*a*) of the Second General Proclamation shall not apply to any such bill.

3. If on the presentation for payment of a bill of exchange, the date of maturity of which has before the Fourth day of October, nineteen hundred and fourteen, become postponed either by virtue of the Bills (Re-acceptance) Proclamation or paragraph (*a*) of the Second General Proclamation (whether or not the date of maturity has been further postponed by virtue of the Third General Proclamation), the bill is not paid, then the date of maturity shall be deemed to be further postponed for fourteen days from the date of such presentation for payment, and the original amount of the bill shall be deemed to be further increased by the amount of interest on the original amount of the bill for fourteen days, calculated at the Bank of England rate current on the date of such presentation for payment.

4. Save as otherwise expressly provided, nothing in this Proclamation shall affect the application of the General Proclamations to payments to which those Proclamations apply, and nothing in this Proclamation shall prevent payments to which this Proclamation applies being made before the expiration of the period for which they are postponed thereunder.

God Save the King

APPENDIX II

MEASURES FOR DEALING WITH BILLS OF EXCHANGE

A.—PROCLAMATION OF SUNDAY, 2ND AUGUST, 1914, FOR POSTPONING THE PAYMENT OF CERTAIN BILLS OF EXCHANGE.

GEORGE R.I.

WHEREAS in view of the critical situation in Europe and the financial difficulties caused thereby it is expedient that the payment of certain bills of exchange should be postponed as appears in this Proclamation:

Now, therefore, We have thought fit, by and with the advice of Our Privy Council, to issue this Our Royal Proclamation, and We do hereby proclaim, direct, and ordain as follows—

If on the presentation for payment of a bill of exchange, other than a cheque or bill on demand, which has been accepted before the beginning of the Fourth day of August, nineteen hundred and fourteen, the acceptor re-accepts the bill by a declaration on the face of the bill in the form set out hereunder, that bill shall, for all purposes, including the liability of any drawer or indorser or any other party thereto, be deemed to be due and be payable on a date one calendar month after the date of its original maturity instead of on the date of its original maturity, and to be a bill for the original amount thereof increased by the amount of interest thereon calculated from the date of re-acceptance to the new date of payment at the Bank of England rate current on the date of the re-acceptance of the bill.

Form of Re-Acceptance

Re-accepted under Proclamation for £ (*insert increased sum*)

Signature__________________________________

Date____________________________

Given at Our Court at Buckingham Palace, this Second day of August, in the year of Our Lord one thousand nine hundred and fourteen, and in the Fifth year of Our Reign.

God Save the King

B.—NOTICE PUBLISHED ON 13TH AUGUST, 1914, CONCERNING THE DISCOUNTING OF BILLS BY THE BANK OF ENGLAND.

THE Chancellor of the Exchequer has for several days past been in close and constant consultation with the Governor of the Bank of England, the bankers, the accepting houses, and the principal traders for the purpose of providing the country with all the banking facilities it needs in the present emergency. We are now able to announce that the Chancellor of the Exchequer has completed arrangements with the Bank of England for terminating the present deadlock in the money market and for enabling the trade and commerce of the country to resume its normal course. The greatest difficulty arose from the stoppage of remittances to London both from the provinces and from other countries, not only in Europe but in all parts of the world. This caused a breakdown in the foreign exchanges and deterred bankers from discounting bills in the normal way. To overcome this difficulty as well as that of providing traders in this country with all the banking facilities they need, the Government have now agreed to guarantee the Bank of England from any loss it may incur in discounting bills of exchange, either home or foreign, bank or trade, accepted prior to 4th August, 1914. Accordingly we are authorized to make the following announcement—

" The Bank of England are prepared on the application of the holder of any approved bill of exchange accepted before the 4th day of August, 1914,

to discount at any time before its due date at Bank Rate without recourse to such holder, and upon its maturity the Bank of England will, in order to assist the resumption of normal business operations, give the acceptor the opportunity until further notice of postponing payment, interest being payable in the meantime at 2 per cent. over Bank Rate varying. Arrangements will be made to carry this scheme into effect so as to preserve all existing obligations.

The Bank of England will be prepared for this purpose to approve such bills of exchange as are customarily discounted by them and also good trade bills and the acceptances of such foreign and Colonial firms and bank agencies as are established in Great Britain."

C.—Statement of the Treasury, Published 5th September, 1914, concerning Advances to Acceptors by the Bank of England, etc.

The breakdown of the foreign exchanges has caused, and is still causing, very great inconvenience to traders throughout the country, and strong representations have been made to the Chancellor of the Exchequer upon the subject. It has been pointed out to him that the dislocation of exchange is exercising an extremely prejudicial influence upon trade generally, and especially upon the foreign trade of the country, and that in the absence of the usual exchange facilities, goods can neither be imported nor exported in any appreciable quantity. To ascertain the causes and to find a remedy for the difficulties in obtaining international exchange, the Chancellor of the Exchequer consulted a large number of leading traders, members of accepting houses, and bankers. After a series of conferences at the Treasury, the Chancellor of the Exchequer now wishes to announce that an arrangement has been arrived at which is designed to remove the difficulties.

Principal Features of the Scheme

The main features of the arrangement may be summarized as follows—

(1) The Bank of England will provide where required acceptors with the funds necessary to pay all approved pre-moratorium bills at maturity. This course will release the drawers and endorsers of such bills from their liabilities as parties to these bills, but their liability under any agreement with the acceptors for payment or cover will be retained.

(2) The acceptors will be under obligation to collect from their clients all the funds due to them as soon as possible, and to apply those funds to repayment of the advances made by the Bank of England. Interest will be charged upon these advances at 2 per cent. above the ruling Bank Rate.

(3) The Bank of England undertakes not to claim repayment of any amounts not recovered by the acceptors from their clients for a period of one year after the close of the war. Until the end of this period the Bank of England's claim will rank after claims in respect of post-moratorium transactions.

(4) In order to facilitate fresh business and the movement of produce and merchandize from and to all parts of the world, the Joint Stock Banks have arranged, with the co-operation, if necessary, of the Bank of England and the Government, to advance to clients the amounts necessary to pay their acceptances at maturity where the funds have not been provided in due time by the clients of the acceptors. The acceptor would have to satisfy the Joint Stock Banks or the Bank of England both as to the nature of the transaction and as to the reason why the money is not forthcoming from the client. These advances would be on the same terms as regards interest as the pre-moratorium bill advances.

The Government is now negotiating with a view to assisting the restoration of exchange between the United States of America and this country.

APPENDIX III

MEASURES FOR PROVIDING AND CONCERNING PAPER CURRENCY

A.—THE CURRENCY AND BANK NOTES ACT, 1914 (4 & 5 GEO. 5, Ch. 14).

An Act to authorize the issue of Currency Notes, and to make provision with respect to the Note Issue of Banks. (*6th August,* 1914.)

BE it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

One Pound and Ten Shilling Currency Notes

1. (1) The Treasury may, subject to the provisions of this Act, issue Currency Notes for one pound and for ten shillings, and those notes shall be current in the United Kingdom in the same manner and to the same extent and as fully as sovereigns and half-sovereigns are current and shall be legal tender in the United Kingdom for the payment of any amount.

(2) Currency Notes under this Act shall be in such form and of such design and printed from such plate and on such paper and be authenticated in such manner as may be directed by the Treasury.

(3) The holder of a Currency Note shall be entitled to obtain on demand, during office hours at the Bank of England, payment for the note at its face value in gold coin which is for the time being legal tender in the United Kingdom.

(4) The Treasury may, subject to such conditions as to time, manner, and order of presentation as they think fit, call in any Currency Notes under this Act on paying for those notes at their face value in gold.

(5) Currency Notes under this Act shall be deemed to be bank notes within the meaning of the Forgery Act, 1913,[1] and any other enactment relating to offences in respect of bank notes which is for the time being in force in any part of the British Islands, and to be valuable securities within the meaning of the Larceny Act, 1861,[2] and any other law relating to stealing which is for the time being in force in any part of the British Islands, and to be current coin of the realm for the purpose of the Acts relating to truck and any other like enactment.

(6) For the purpose of meeting immediate exigencies all Post Orders issued either before or after the passing of this Act shall temporarily be current and legal tender in the United Kingdom in the same manner and to the same extent and as fully as current coins, and shall be legal tender in the United Kingdom for the payment of any amount.

The holder of any such Postal Order shall be entitled to obtain on demand, during office hours at the Bank of England, payment for the Postal Order at its face value in any coin which is for the time being legal tender in the United Kingdom for the amount of the note.

Provisoes (*b*) and (*c*) to subsection (1) of section twenty-four of the Post Office Act, 1908,[3] shall not apply to any such Postal Orders.

This subsection shall have effect only until His Majesty by proclamation revokes the same, and any proclamation revoking this subsection may provide for the calling in or exchange of any Postal Orders affected thereby.

Issue of Currency Notes

2. Currency Notes may be issued to such persons and in such manner as the Treasury direct, but the amount of any notes issued to any person shall, by virtue of this Act and without registration or further assurance, be a

[1] 3 & 4 Geo. 5, c. 2.
[2] 24 & 25 Vict. c. 96
[3] 8 Edw. 7, c. 48.

floating charge in priority of all other charges, whether under statute or otherwise, on the assets of that person.

Authority to Issue Bank Notes Beyond Limit

3. The Governor and Company of the Bank of England and any persons concerned in the management of any Scottish or Irish bank of issue may, so far as temporarily authorized by the Treasury and subject to any conditions attached to that authority, issue notes in excess of any limit fixed by law; and those persons are hereby indemnified, freed, and discharged from any liability, penal or civil, in respect of any issue of notes beyond the amount fixed by law which has been made by them since the First day of August, nineteen hundred and fourteen in pursuance of any authority of the Treasury or of any letter from the Chancellor of the Exchequer, and any proceedings taken to enforce any such liability shall be void.

Power to make Bank Notes not otherwise Legal Tender, Legal Tender in Scotland and Ireland

4. Any bank notes issued by a bank of issue in Scotland or Ireland shall be legal tender for a payment of any amount in Scotland or Ireland respectively, and any such bank of issue shall not be under any obligation to pay its notes on demand except at the head office of the bank, and may pay its notes, if thought fit, in Currency Notes issued under this Act:

Provided that notes which are legal tender under this section shall not be legal tender for any payment by the head office of the bank by whom they are issued for the purpose of the payment of notes issued by that bank.

This section shall have effect only until His Majesty by proclamation revokes the same, and any proclamation revoking this section may provide for the calling in or exchange of notes affected thereby.

Interpretation, Short Title, and Extent

5. (1) In this Act, the expression " bank of issue " means any bank having power for the time being to issue bank notes.

(2) This Act may be cited as the Currency and Bank Notes Act, 1914.

(3) This Act shall apply to the Isle of Man as if it were part of the United Kingdom, but shall not apply to any other British Possession.

B.—EXPLANATORY MEMORANDUM BY THE TREASURY.

THE following are the arrangements made in accordance with the provisions of the Currency and Bank Notes Act, 1914, for placing Currency Notes at the disposal of the banks for meeting exceptional demands.

(1) *England and Wales*

Currency Notes are issued through the Bank of England to bankers as and when required up to a maximum limit not exceeding, in the case of any bank, 20 per cent. of its liabilities on deposit and current accounts.

The amount of notes issued to each bank is treated as an advance by the Treasury to that bank bearing interest from day to day at the current Bank Rate, the security for the Treasury advance consisting of a floating charge on the assets of the bank up to the amount of the notes issued. The bank is permitted to repay the whole or any part of any advance at any time. Any amount repaid can be renewed if and when necessity arises, provided that the total amount outstanding at any one time does not exceed the authorized percentage of the bank's liabilities.

Any sums received by the Bank of England in repayment of advances are either applied forthwith to cancelling any Currency Notes which have been returned from circulation and are for the time being in the hands of the Bank of England, or, in so far as any such sums may exceed the amount of

Currency Notes returned from circulation in the hands of the Bank of England at the time of receipt, are carried to a separate account in the books of the Bank of England and applied to the cancellation of notes as and when they return from circulation.

In order to give the banks the advantage of the credit allowed under this arrangement even though actual currency may not be required, it is proposed by the amending Bill to take power to issue certificates in lieu of actual notes.

The effect of the issue of these certificates will be that the banks will be able to obtain credits with the Bank of England on the same terms as Currency Notes and the expense of printing and handling notes will be avoided except in so far as the notes may be required for actual circulation.

(2) *Scotland and Ireland*

The arrangement in England and Wales applies generally to Scotland and Ireland; but in the case of banks of issue in Scotland and Ireland, Currency Notes, instead of being issued to the public, are used as cover for the banks' own notes. This arrangement has in practice the effect of enabling the Scottish and Irish banks of issue to exceed the normal limits of issue of fiduciary notes so long as such excess issues are covered by Currency Notes.

The new certificates will also be available for the purpose of cover for these issues.

(Treasury Minutes dated 6th August, 20th August, 22nd October, 1914, and 19th January, 1915, set out in detail the conditions under which Currency Notes were to be issued to banks within the United Kingdom, including the Post Office Savings Bank and the Trustee Savings Banks, and provided for the eventual payment to the Exchequer (after allowing for expenses) of the interest received by the Bank of England on account of advances made to banks in the form of Currency Notes in accordance with the Currency and Bank Notes Act, 1914. These Minutes also specified the design of the Currency Notes and the quality and nature of the paper to be used for the issue.)

C.—DISPOSAL OF INTEREST RECEIVED ON ACCOUNT OF CURRENCY NOTE ISSUE.

TREASURY MINUTE DATED THE 3RD MAY, 1915

My Lords read again Their Minute of the 6th August, 1914, on the subject of the issue of Currency Notes under the Currency and Bank Notes Act, 1914 (4 & 5 Geo. 5, c. 14).

By paragraph 5 of that Minute it was directed that all sums payable in respect of interest upon advances made by means of the issue of Currency Notes shall be paid to the Bank of England, and shall, after deduction by the Bank of England of whatever amount may be agreed between the Bank of England and the Treasury as a fair remuneration of its services in connection with the issue and withdrawal of Currency Notes, be paid by them into the Exchequer, but no directions have been given as to the treatment of the interest payable in respect of securities held on account of the Currency Note Redemption Account.

The Chancellor of the Exchequer recommends to the Board that these directions should now be revised and extended to interest earned on these latter securities.

He states to the Board that the Bank have informed him that during the continuance of the war they do not propose to make any charge for their services in connection with the issue.

The question of remuneration to the Bank does not therefore at present

arise, but if and when it arises the Chancellor is of opinion that it will be more proper that such remuneration should, with the other expenses of issue, be charged against moneys provided by Parliament, and that the question of the appropriation in aid of such expenses of the whole or any part of the sums payable to the Exchequer in respect of the issue should be considered in due course.

The Chancellor now proposes that all interest received whether upon advances made in Currency Notes or upon securities held for the Currency Note Redemption Account should be utilized, in the first place, in order to provide a fund for meeting any losses which may from time to time be incurred upon the realization of the securities, and that the balance after making suitable provision for this purpose should be paid into the Exchequer, and he accordingly recommends that their Lordships should give directions that—

1. The interest on all advances made in Currency Notes and on the securities held for the Currency Note Redemption Account shall, as it accrues, be credited to the assets of that Account as shown in the weekly return and the amount so credited shall be shown under a separate heading among the liabilities under the title of " Investments Reserve Account."

2. The Securities held on account of the Currency Note Redemption Account shall continue to be shown in the return at cost price and any profit or loss upon realization or repayment shall when it accrues be credited or debited as the case may be to the " Investments Reserve Account." Any advances made in Currency Notes which may prove to be irrecoverable shall when written off be debited to that Account.

3. If at any time the amount standing to the credit of the Investments Reserve Account exceeds by more than £100,000 the proportion which may be fixed by their Lordships from time to time as necessary to provide an adequate reserve, due regard being had to the character of the securities held and of the other assets of the fund, the whole amount of the excess over the fixed proportion shall be transferred to the Exchequer.

My Lords concur and are pleased to direct that the amount below which the balance of the Investments Reserve Account shall not be reduced by transfers to the Exchequer be fixed for the time being at 5 per cent. of the total securities held and advances outstanding.

D.—MAXIMUM LIMIT FIXED TO FIDUCIARY ISSUE OF CURRENCY NOTES.

TREASURY MINUTE, DATED THE 15TH DECEMBER, 1919

The Chancellor of the Exchequer draws the attention of the Board to paragraph 8 of the Final Report of the Committee on Currency and Foreign Exchanges after the War, which recommends the imposition of a maximum limit on the issue of Currency Notes under the Currency and Bank Notes Act, 1914. The Chancellor proposes to the Board that steps shall be taken to give effect to the recommendation that the actual maximum fiduciary circulation of Currency Notes in any year shall be the fixed maximum for the following year.

The maximum fiduciary circulation during the expired portion of the current calendar year has been £320,608,298 10s. and the Chancellor accordingly proposes that directions shall now be given to the Bank of England restricting them from issuing Currency Notes during the 12 months commencing the 1st January, 1920, in excess of a total of £320,600,000, except against gold or Bank of England Notes, and from issuing in the calendar year commencing 1st January in any year henceforward notes in excess of the actual maximum fiduciary circulation of the preceding 12 months.

My Lords concur.

Let copies of this Minute be transmitted to the Banks of England and Ireland, the Bankers' Clearing House Committee, and the Comptroller and Auditor-General: and let copies be presented to both Houses of Parliament.

E.—CURRENCY NOTES OF THE FIRST AND SECOND ISSUES CALLED IN.

TREASURY ORDER, DATED 11TH JUNE, 1920

Whereas it is enacted by sub-section (1) of Section one of the Currency and Bank Notes Act, 1914 (hereinafter referred to as "the said Act"), that the Treasury may, subject to the provisions of the said Act, issue Currency Notes for one pound and for ten shillings, and that those notes shall be current in the United Kingdom in the same manner and to the same extent and as fully as sovereigns and half-sovereigns are current, and shall be legal tender in the United Kingdom for the payment of any amount:

And whereas it is enacted by sub-section (4) of the said Section that the Treasury may, subject to such conditions as to time, manner and order of presentation as they think fit, call in any Currency Notes under the said Act on paying for those notes at their face value in gold:

And whereas it is enacted by Section one of the Currency and Bank Notes (Amendment) Act, 1914,[1] that the power of the Treasury to call in Currency Notes under the said sub-section (4) of Section one of the said Act, shall be extended so as to include a power to call in Currency Notes on exchanging the notes so called in for other notes of the same face value issued under the said Act:

And whereas in pursuance of the said sub-section (1) of Section one of the said Act, the Treasury on the sixth day of August, nineteen hundred and fourteen, made provision for the issue of currency notes for one pound and ten shillings respectively (hereinafter referred to as "Currency Notes of the first issue") and such Currency Notes were issued by the Treasury accordingly:

And whereas the Treasury on the twenty-second day of October, nineteen hundred and fourteen, directed that as from the twenty-third day of October, nineteen hundred and fourteen, the issue of Currency Notes of the first issue for one pound should cease and that the Currency Notes for one pound issued on or after that date (hereinafter referred to as Currency Notes of the second issue for one pound) should be of a new design:

And whereas the Treasury on the nineteenth day of January, nineteen hundred and fifteen, directed that as from the twenty-first day of January, nineteen hundred and fifteen, the issue of Currency Notes of the first issue for ten shillings should cease and that the Currency Notes for ten shillings issued on or after that date (hereinafter referred to as Currency Notes of the second issue for ten shillings) should be of a new design:

And whereas the Treasury on the twelfth day of January, nineteen hundred and seventeen, directed that as from the twenty-second day of January, nineteen hundred and seventeen, or as soon as might be thereafter the issue of Currency Notes of the second issue for one pound should cease and that the Currency Notes for one pound issued thenceforward should be of a new design, and the issue of Currency Notes of the second issue for one pound accordingly ceased on the first day of February, 1917:

And whereas the Treasury on the twenty-first day of October, nineteen hundred and eighteen, directed that as from the twenty-second day of October, nineteen hundred and eighteen, or as soon as might be thereafter, the issue of Currency Notes of the second issue for ten shillings should cease and that the Currency Notes for ten shillings issued thenceforward should be of a new design, and the issue of Currency Notes of the second issue for ten shillings accordingly ceased on the second day of November, 1918:

And whereas certain of the Currency Notes of the first and second issues still remain in circulation and it is desirable that they should be called in:

Now, therefore, the Treasury, in pursuance of their powers in that behalf, hereby call in all Currency Notes of the first and second issues, and direct

[1] 4 & 5 Geo. 5, c. 72.

that as from the date of this order all such Currency Notes shall cease to be current or legal tender within the United Kingdom:

Provided that the holder of any Currency Notes of the first or second issues shall, on application at any time before the first day of September, nineteen hundred and twenty, during office hours at any Money Order Office in the United Kingdom or at the Bank of England or the Bank of Ireland be entitled to receive in exchange for these notes after due examination thereof other Currency Notes of the same face value which have been issued and are for the time being legal tender in the United Kingdom under the said Act.

This 11th day of June, 1920.

JAMES PARKER,
WM. SUTHERLAND,
Two of the Lords Commissioners of
His Majesty's Treasury.

Treasury Chambers,
Whitehall.

APPENDIX IV

THE COURTS (EMERGENCY POWERS) ACT, 1914 (4 & 5 GEO. 5)

An Act to give, in connection with the present War, further powers to Courts in relation to the remedies for the recovery of money, and in relation to other similar matters. (*31st August*, 1914.)

BE it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

Powers of Courts to Defer Execution, etc.

1. (1) From and after the passing of this Act no person shall—

(*a*) proceed to execution on, or otherwise to the enforcement of, any judgment or order of any court (whether entered or made before or after the passing of this Act) for the payment or recovery of a sum of money to which this subsection applies, except after such application to such court and such notice as may be provided for by rules or directions under this Act; or

(*b*) levy any distress, take, resume, or enter into possession of any property, exercise any right of re-entry, foreclose, realize any security (except by way of sale by a mortgagee in possession), forfeit any deposit, or enforce the lapse of any policy of insurance to which this subsection applies, for the purpose of enforcing the payment or recovery of any sum of money to which this subsection applies, or, in default of the payment or recovery of any such sum of money, except after such application to such court and such notice as may be provided for by rules or directions under this Act.

This subsection shall not apply to any sum of money (other than rent not being rent at or exceeding fifty pounds per annum) due and payable in pursuance of a contract made after the beginning of the Fourth day of August, nineteen hundred and fourteen.

This subsection applies to life or endowment policies for an amount not exceeding twenty-five pounds, or payments equivalent thereto, the premiums in respect of which are payable at not longer than monthly intervals, and have been paid for at least the two years preceding the Fourth day of August, nineteen hundred and fourteen.

(2) If, on any such application, the court to which the application is made is of opinion that time should be given to the person liable to make the payment on the ground that he is unable immediately to make the payment by reason of circumstances attributable, directly or indirectly, to the present war, the court may, in its absolute discretion, after considering all the circumstances of the case and the position of all the parties, by order, stay execution or defer the operation of any such remedies as aforesaid, for such time and subject to such conditions as the court thinks fit.

(3) Where a bankruptcy petition has been presented against any debtor, and the debtor proves to the satisfaction of the court having jurisdiction in bankruptcy that his inability to pay his debts is due to circumstances attributable, directly or indirectly, to the present war, the court may, in its absolute discretion, after considering all the circumstances of the case and the position of all the parties, at any time stay the proceedings under the petition for such time and subject to such conditions as the court thinks fit.

(4) This Act shall apply to all proceedings for the recovery of possession of tenements under the Small Tenements Recovery Act, 1838,[1] as if they were in all cases proceedings for the payment or recovery of a sum of money due and payable on account of rent.

(5) The Lord Chancellor may make such rules and give such directions as he thinks fit for the purpose of giving full effect to this Act, and may, by those rules or directions, provide for any proceedings for the purposes of this Act being conducted, so far as desirable, in private and for the remission of any fees.

(6) The powers given under this Act shall be in addition to, and not in derogation of, any other powers of any court.

(7) Nothing in this Act shall affect any right or power of pawnbrokers to deal with pledges, or give any power to stay execution or defer the operation of any remedies of a creditor in the case of a sum of money payable by, or recoverable from, the subject of a Sovereign or State at war with His Majesty.

(8) Any stay of execution or of other proceedings, and any postponement of the operation of the remedies of a creditor, which has been granted or ordered by any court since the commencement of the present war and before the passing of this Act shall be as valid as if this Act had been in operation when the stay or postponement was granted or ordered.

Short Title, Application, and Duration

2. (1) This Act may be cited as the Courts (Emergency Powers) Act, 1914.

(2) In the application of this Act to Scotland the Court of Session shall be substituted for the Lord Chancellor; " Act of Sederunt " shall be substituted for " rules "; " a petition for sequestration " shall be substituted for " a bankruptcy petition "; " diligence " shall be substituted for " execution "; and " decree " shall be substituted for " judgment or order," and shall be deemed to include any warrant authorizing diligence; " creditor in a heritable security " shall be substituted for " mortgagee "; and " proceedings in removings and ejections in the case of subjects let at a rent not exceeding twenty-one pounds " shall be substituted for " proceedings for the recovery of possession of tenements under the Small Tenements Recovery Act, 1838."

(3) In the application of this Act to Ireland the Lord Chancellor of Ireland shall be substituted for the Lord Chancellor.

(4) His Majesty may, by Order in Council, at any time determine the operation of this Act, or provide that this Act shall have effect subject to such limitations as may be contained in the Order; but, subject to the operation of any such Order in Council, this Act shall have effect during the continuance of the present war, and for a period of six months thereafter.

[1] 1 & 2 Vict. c. 74.

APPENDIX V

Government War Obligations Act, 1914 (5 Geo. 5, Ch. 11)

An Act to make provision with respect to obligations incurred by or on behalf of His Majesty's Government for the purposes of the present war or in connection therewith and for other purposes in relation thereto.

(27th November, 1914.)

Be it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

1. There shall be paid out of moneys provided by Parliament, or, if those moneys are insufficient, there shall be charged on and paid out of the Consolidated Fund, or the growing produce thereof, such sums as may be required for the purpose of giving effect to any such obligations incurred by or on behalf of His Majesty's Government before the passing of this Act as are set out in the Schedule to this Act (in this Act referred to as Government war obligations).

2. (1) No contract of re-insurance for the purpose of carrying out any Government war obligation to which the Government, or any person on behalf of the Government, are a party, shall be liable to stamp duty and no contract of insurance, re-insurance, or other document for the purpose of carrying out any such obligation shall be void by reason only that it is not stamped or expressed in a policy of sea insurance, or is made for a term exceeding twelve months.

(2) No provisions of the Companies (Consolidation) Act, 1908,[1] or the Bankruptcy and Deeds of Arrangement Act, 1913,[2] or any other Act as to registration of charges shall apply to any charges given for the purpose of obtaining any loan guaranteed by or on behalf of the Government in pursuance of any war obligation; and no notice of any such charge need be registered or notified.

3. Any policies of insurance or re-insurance granted, or any contract made, or other action taken, by any association or body of persons approved by the Board of Trade for the purpose of carrying out any Government scheme in connection with the present war of insurance of ships or cargo against risk of the King's enemies or for the relief of dependents of persons on insured ships shall, if and so far as the Board of Trade so direct, be deemed to be valid, notwithstanding that the granting of the policy, or the making of the contract, or the taking of the action was beyond the powers of the association or body of persons.

4. This Act may be cited as the Government War Obligations Act, 1914.

SCHEDULE

Government War Obligations

Obligations incurred in connection with the present war in respect of—

1. Guarantees given to the Bank of England in connection with—
   (*a*) The discount on bills of exchange;
   (*b*) Advances to acceptors of bills of exchange;
   (*c*) Advances in connection with loans made to members of the Stock Exchange.

2. Guarantees given in connection with bills of exchange drawn by traders having debts due from abroad which are not immediately recoverable, and in connection with advances to traders to enable them to meet liabilities under contracts entered into before the outbreak of war;

[1] 8 Edw. 7, c. 69.
[2] 3 & 4 Geo. 5, c. 34.

3. Payments on contracts of insurance or re-insurance against war risks of ships or cargo or for the relief of dependents of persons on insured ships so far as provision is not made for those payments by the application of premiums or otherwise;

4. Any loan raised by any of the Powers allied in the present war or by the Government of Egypt or by the Government of any of His Majesty's Dominions, or any British Possession or Protectorate;

5. The maintenance or assistance, in connection with the present war, of food supply, trade, industry, business, or communications in the United Kingdom or in any other country, or the relief of distress in the United Kingdom or in any other country.

APPENDIX VI

Coinage Act, 1920 (10 Geo. 5, Ch. 3)

An Act to amend the Law in respect of the Standard Fineness of Silver Coins current in the United Kingdom and in other parts of his Majesty's Dominions.

(*31st March*, 1920.)

Be it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

1. (1) The first Schedule of the Coinage Act, 1870, as amended by Section two of the Coinage Act, 1891, shall, as regards coins made after the commencement of this Act, have effect as though for the words "thirty-seven-fortieths fine silver, three-fortieths alloy; or millesimal fineness 925," in the column relating to standard fineness there were substituted the words "one-half fine silver, one-half alloy; or millesimal fineness 500," and as though for the figure "4" in the column relating to the remedy allowance in respect of millesimal fineness there were substituted the figure "5."

(2) Where by virtue of a proclamation made under Section eleven of the Coinage Act, 1870, the whole or any part of that Act is in force in any British possession at the date of the commencement of this Act, that Act shall as from that date apply in that possession as amended by this Act, and any Order in Council or proclamation directing that any coins which under the Coinage Acts, 1870 and 1891, are legal tender in the United Kingdom shall be current and legal tender in any British possession shall extend to coins which are legal tender in the United Kingdom under those Acts as amended by this Act:

Provided that the provisions of this subsection shall not apply as respects any self-governing dominion unless and until those provisions are adopted as regards the dominion by a proclamation of the governor-general or governor.

2. The standard trial plates of silver to be used for the purpose of the trial of the pyx shall, instead of being made of a standard fineness in conformity with the provisions of the Coinage Acts, 1870 and 1891, be made of pure silver.

3. (1) This Act may be cited as the Coinage Act, 1920, and shall be construed as one with the Coinage Acts, 1870 to 1891, and those Acts and this Act may be cited together as the Coinage Acts, 1870 to 1920.

(2) In this Act the expression "self-governing dominion" means the Dominion of Canada, the Commonwealth of Australia, the Dominion of New Zealand, the Union of South Africa, and Newfoundland.

APPENDIX VII

Gold and Silver (Export Control, etc.) Act, 1920

(10 & 11, Geo. 5, Ch. 70)

An Act to control the exportation of gold and silver coin and bullion, and to prohibit the melting or improper use of gold and silver coin.

(*23rd December*, 1920.)

Be it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

1. (1) Section eight of the Customs and Inland Revenue Act, 1879 (which enables the exportation of certain articles to be prohibited), shall have effect as if, in addition to the articles therein mentioned, there were included the following articles, that is to say, gold or silver coin and gold or silver bullion.

(2) If any person acts in contravention of or fails to comply with any condition attached to a licence authorizing the exportation of any goods prohibited to be exported by virtue of this section, he shall for each offence, without prejudice to any other liability, be liable to a Customs penalty of one hundred pounds.

(3) Gold produced in any part of His Majesty's Dominions and imported into the United Kingdom under any arrangement approved by the Treasury may, notwithstanding anything in this section, be exported in accordance with the terms of the arrangement.

(4) In this Act the expression "gold or silver bullion" includes gold or silver partly manufactured and any mixture or alloy containing gold or silver.

(5) This section shall continue in force until the thirty-first day of December, nineteen hundred and twenty-five, and no longer, unless Parliament otherwise determines.

2. (1) It shall not be lawful for any person, except under and in pursuance of a licence granted by the Treasury, to melt down, break up, or use otherwise than as currency any gold or silver coin which is for the time being current in the United Kingdom or in any British Possession or foreign country.

(2) If any person acts in contravention of this section, or acts in contravention of or fails to comply with any condition attached to a licence granted under this section, he shall, for each offence, be liable on summary conviction to a fine not exceeding one hundred pounds, or to imprisonment with or without hard labour for a term not exceeding two years, or to both such fine and imprisonment, and, in addition to any other punishment, the court dealing with the case may order the articles in respect of which the offence was committed to be forfeited.

3. This Act may be cited as the Gold and Silver (Export Control, &c.) Act, 1920.

APPENDIX VIII

REPORT FROM THE SELECT COMMITTEE ON PREMIUM BONDS

(Dated 16th January, 1918)

The Select Committee appointed to enquire into and report on the desirability or otherwise of raising money for the purpose of the war by the issue of Premium Bonds have agreed to the following Report—

1. Having in view the limited nature of our reference, we have not entered upon the consideration of the details of the very numerous schemes for

Premium Bonds which have been proposed, nor have we dealt with the question from the aspect of normal finance in times of peace.

The issues were, however, so varied and contentious that we found that it was necessary to obtain a good deal of evidence, and we have examined 35 witnesses, amongst whom were three Members of Parliament belonging to the Labour Party, several Bankers, including foreign Bankers, two Chief Constables of large industrial cities, official witnesses from the Treasury, Board of Trade, and Post Office, and representatives of Chambers of Commerce, large employers of labour, of the Co-operative Societies, and of various religious bodies.

2. The first point to decide was to arrive at a definition of a Premium Bond, and we adopted in the main the definition, which had been accepted by the Committee which had for some time promoted the issue of such Bonds, namely, that the term Investment and Premium Bond should mean Bonds repayable after a fixed term of years at par plus a moderate rate of compound interest, not less than the 2½ per cent. now paid on the Government Savings Banks deposits and having the feature that a certain number should be drawn each half-year for payment at a premium over and above the issue price, both interest and premium being paid free of tax. An example of such an issue would be as follows—

The Bonds might be issued by the Treasury in series of £10,000,000, as and when required, and be repayable in 10 years, with 2½ per cent. compound interest, free of tax. The difference between 2½ per cent. and 4 per cent.—the latter being the current rate of interest on tax-free Government Bonds—leaves a balance of 1½ per cent., which would provide an ample Fund out of which substantial premiums could be paid on many thousands of Bonds drawn and paid off half-yearly, the premiums ranging possibly from £5 to £1,000. Bonds not drawn would be repayable on maturity at 26s. (for each £), that sum representing the capital value together with compound interest at 2½ per cent.

3. We understand that the Government has been advised to the effect that no issue which involves an element of chance could be made without an Act of Parliament. Since the Act of 1823, prohibiting lotteries, there has been no Act of Parliament, with the single exception of the Art Union Lotteries Act, 1846, which has directly or indirectly legalized lotteries.

4. Before offering advice on the initiation of a form of investment differing in character from the existing methods of Government finance, we desired to obtain information upon various points—

(a) Are the existing Government issues for large and small investors sufficient for the country's financial needs in the present war circumstances?

(b) Is there any field of investment at present untapped?

(c) Is the amount of money to be tapped large enough to justify a departure from existing methods?

(d) Would new methods divert money rather than bring in new money?

(e) And whether the issue of Premium Bonds would in any way prejudice our financial credit and standing at home or abroad.

5. So far as the large investor is concerned the evidence before us was conclusive that an issue of Premium Bonds would have no effect at all upon the larger Government investments from the financial interests in the City which pass through the Bank of England, and therefore that side of National Finance need not be entered upon. If present methods should prove to be insufficient, some other alternative than Premium Bonds as defined above must be sought to attract money from the large investor.

We are satisfied that, so far as the general public and the small investor are concerned, the present Government issues fail to enlist all the financial support that might be obtained.

6. Amongst the large section of the public who are not in trade, nor wage-earners, investment in non-Government securities still largely prevails, on

account of the desire for more remunerative, though necessarily speculative, stocks, and this source of help, financially, can only be obtained by some more attractive Government issue.

There is also clear proof that the weekly wage-earners, especially the men, demand an investment, which would appeal to them primarily in that there would be a chance of substantial increase of their capital, and that the ordinary rate of interest, amounting as it must to the small investor only to a few shillings a year, even at the rate of 5 per cent., is of secondary importance to them.

We carefully considered whether the increase of wage throughout the country had been proportionate to the increased cost of living, and, though in some cases this may not be so, nearly all the witnesses agreed that, owing to the larger numbers of workers in most households, and the very busy state of the labour market, especially in munition areas, there is a considerable margin of wages which is not at present being invested but which is being spent upon luxuries in some cases, and in many cases upon articles which in war time might be dispensed with.

7. Great diversity of opinion has been evinced as to the amount that would be attainable from the weekly wage-earners and other classes by an issue of Premium Bonds, and the estimates varied from 10 millions to 250 millions a year. It must be remembered that these estimates include a good deal of money which would, in the absence of any new issue, be invested in existing stocks, and it is only new money, that is, money not forthcoming at present for Government securities, that is wanted. Probably, though all estimates are quite problematical, about 80 to 100 millions a year would be the most new money that could be expected from sources at present untouched.

8. We had a good deal of interesting evidence as to the effect of an issue of Premium Bonds on the War Savings Committees and Associations, which number now over 40,000, and upon their investments. Very good work has been done by these Associations, especially through our schools, and their patriotic exertions, mainly on voluntary lines, have resulted in a very large sale of War Savings Certificates, and of small amounts of War Loan and Bonds.

Undoubtedly a good deal of money would be diverted from these investments by an issue of Premium Bonds, for it was admitted by many witnesses—notably several very hostile to Premium Bonds—that the War Savings Certificate does not appeal to the working man, and that his investments in them were due to patriotism and persuasion rather than to personal inclination. Instances were given to us to show this indifference. There would be strong moral objections to the use of School War Savings Associations for the sale of Premium Bonds, and there are also practical considerations which might make it difficult for the War Savings Committee to adopt Premium Bonds as part of their propaganda.

9. As regards the effect of an issue of Premium Bonds upon the financial prestige and credit of the country, the larger number of those who gave evidence, as representing financial interests, were of the opinion that, for the purpose of the war, when all conditions are abnormal, it would be in no way detrimental or prejudicial.

On the other hand, some witnesses held very strong opinions of an opposite character.

So far as neutral countries were affected, the evidence rather went to prove that Premium Bonds might be taken up by investors in those countries, and thus the difficulties of exchange would be so far lightened. Upon this point we made special inquiry as to how far Premium Bonds had been made use of in foreign countries, and whether any lessons can be drawn from such precedents. Generally speaking, foreign Governments have not made use of this form of investment, except for small amounts or for local purposes; but in many of these countries there is no objection taken to actual lotteries (in

Germany these have always been allowed), so that Premium Bonds would be less required to appeal to the speculative instinct.

In France, however, Premium Bonds have been for a long time a very popular form of investment, and have been used largely to finance Municipal, Local, and even State schemes, such as the Suez Canal. These issues have never been actually made by any French Government, but every issue has State sanction and approval.

It is estimated that there are now Premium Bonds in existence in France to the amount of 400 million pounds, and there is apparently no prejudice against them, but on the contrary they are held to promote thrift, and to form a security which is not easily parted with. Two factors must, however, be taken into account: that the French small investor values highly his interest, paid half-yearly, and that most of the Bonds are issued at a good rate of interest. These factors must be borne in mind if there was an issue at any time in this country, as, if interest is to be paid yearly or half-yearly, the value of the Bond cannot be less than the lowest French value, namely, 100 francs, or £4.

10. After this survey of the field of finance we arrive at the direct issue whether Premium Bonds are desirable for the purpose of War Finance, and here we come to very debatable ground. In 1916 the Committee upon War Loans for Small Investors considered the question of "Bonus Bonds" and reported as follows: "Bonus Bonds would probably be a very attractive form of investment, and very considerable sums might be obtained by an issue of this character. But, on the other hand, objection would not improbably be taken to any proposal in which the element of chance is involved, and, as opinion in the Committee was somewhat sharply divided, we are not able to make any recommendation on the subject."

We can only confirm the difficulties which the former Committee found themselves confronted with, and candidly admit that the same sharp division of opinion is also manifest amongst the members of our Committee. Out of 35 witnesses, 18 were in favour of Premium Bonds, 12 were against, and 5 were neutral or official, and we note, with interest, that the division of opinion does not follow any clear and regular line, as, for instance, even in the ranks of ministers of various religious denominations, who naturally all hold strong views against gambling, there was by no means unanimity in their opinions upon the morality of the Government's connection with Premium Bonds.

We are, however, impressed by the evidence as to the existence of opposition to any State action which might be held to introduce an element of chance in our National Finance, and it would not be possible to treat Premium Bonds as an uncontroversial war measure.

To sum up our conclusions, we beg to report that the present opportunities of investment for the general public are not sufficient to obtain their free and full support, and that there is a considerable untapped source of investment, which might be secured for war needs by means of an issue of Bonds, which would, by a speculative element, whilst preserving the capital intact, attract the savings of the small investor to whom the ordinary flat rate of interest does not appeal.

We doubt, however, whether the amount of new money to be obtained would justify any change of a contentious character in our financial methods, and we are satisfied that such strong views are held with regard to Premium Bonds that legislation to sanction them would be difficult to obtain, and that such a proposal might cause a controversy in the country which would be most undesirable. We do not therefore advise that an issue of Premium Bonds be made at the present time, or until further efforts have been made to render present issues more attractive to the investor.

APPENDIX IX

REPORT OF THE COMMITTEE ON FINANCIAL FACILITIES

TERMS OF APPOINTMENT

TREASURY MINUTE DATED 26TH NOVEMBER, 1917

THE Chancellor of the Exchequer states to the Board that he has, jointly with the Minister of Reconstruction, appointed a Committee consisting of the following—

SIR RICHARD V. VASSAR-SMITH, Lloyds Bank (*Chairman*),
SIR JOHN BRADBURY, K.C.B., Secretary to the Treasury,
MR. A. E. L. CHORLTON, of Ruston, Proctor & Company, Limited,
MR. E. BROCKLEHURST FIELDEN, Deputy Chairman, Lancashire and Yorkshire Railway Company,
SIR ALGERNON F. FIRTH, President of the Associated Chambers of Commerce of the United Kingdom,
MR. ROBERT FLEMING,
MR. A. C. D. GAIRDNER, Union Bank of Scotland,
MR. FREDERICK C. GOODENOUGH, of Messrs.Barclay & Company, Limited,
SIR ALEXANDER MCDOWELL, K.B.E.,
SIR ALEXANDER ROGER, Ministry of Reconstruction,
MR. JOHN SAMPSON, as Representative of the Controlled Establishments Association,
MR. A. W. TAIT, of Messrs. G. A. Touche & Company,
with
MR. R. C. SMALLWOOD, as Secretary,

to consider and report whether the normal arrangements for the provision of financial facilities for trade by means of existing banking and other financial institutions will be adequate to meet the needs of British industry during the period immediately following the termination of the war, and, if not, by what emergency arrangement they should be supplemented, regard being had in particular to the special assistance which may be necessary—

(*a*) To facilitate the conversion of works and factories now engaged upon war work to normal production;

(*b*) To meet the exceptional demands for raw materials arising from the depletion of stocks.

My Lords concur.

On the 20th December, 1917, Mr. H. C. Hambro was added to the Committee.

We desire to express our deep sense of regret at the death in March last of our colleague the late Sir Alexander McDowell, K.B.E. Although illness prevented him from attending any of our meetings, Sir Alexander McDowell took a close interest in our proceedings, and we feel that through his death we have lost a colleague whose knowledge and wide experience would have been of great assistance in dealing with the problems which have been submitted to us.

TO THE LORDS COMMISSIONERS OF HIS MAJESTY'S TREASURY AND THE MINISTER OF RECONSTRUCTION

MY LORDS AND SIR,

INTRODUCTORY

1. We have now the honour to submit our Report upon the matters referred to us. In the course of our enquiry we have held seventeen meetings and

examined eleven witnesses; we have also considered a large amount of documentary evidence, together with the reports of certain Departmental Committees dealing with various branches of trade and industry.

2. Although the provision of financial facilities is undoubtedly an important factor in the re-conversion of trade and industry, we do not think that it is by any means the primary factor. The remedy for the wastage of capital during the war lies mainly in increased production and genuine saving. A rapid return to normal conditions will depend primarily on the amount of raw material and labour available, and should there be a shortage in either case, upon the efficient distribution of the available supplies to the most urgent national needs of production. This problem is intimately bound up with questions such as the amount and utilization of the available shipping tonnage, the rectification and maintenance of the foreign exchanges, and the manner in which the Currency Note issue will be dealt with. Much depends upon the successful solution of these problems, which form the foundations upon which financial policy rests ultimately, particularly in connection with the granting of credit facilities.

3. The terms of reference which have been submitted to us appear to fall naturally into two main divisions—

(i) The Financial needs of trade immediately after the war, and the respect in which these needs will differ from the needs under normal conditions.

(ii) The provision of Financial Facilities to meet these needs.

In the first part of our Report we propose, therefore, to deal with the Financial Requirements of Trade and Industry.

PART I

THE FINANCIAL NEEDS OF TRADE AND INDUSTRY AFTER THE WAR

4. In the course of our enquiry we came to the conclusion that it was not possible to obtain information upon which to frame an estimate of the total cost involved in the re-conversion of industry from a war to a peace footing. And, as the special circumstances of many of the more important trades and industries have been, or are now, the subject of enquiry by Special Committees appointed by various Departments of State, we determined, after a review of all the circumstances, to rely mainly upon documentary evidence in connection with this section of our enquiry.

Reconstruction of Works

5. One of the largest factors in the demand for assistance undoubtedly will be the necessity for re-equipping factories and works, and altering machinery only useful for war production, to machinery suitable for peace-time production. The volume of the demand will differ in various industries in accordance with the magnitude of the displacement which has taken place, and the degree in which the character of the war output is removed from the normal peace-time output of the firms concerned. During the Reconstruction period the manufacturer will be confronted by two separate calls upon his financial resources, operating more or less at the same time. In the first place, he will have to provide for the expenditure necessary for the re-conversion of his plant and works; and, secondly, in order to produce the same amount of output after the war as was produced before the war, a larger amount of working capital will be required to meet the enhanced cost of labour and materials and the general increase in standing charges. Stocks of raw materials have been depleted and stocks of the manufactured articles have likewise been depleted, or have disappeared altogether. Raw material

must be acquired, generally speaking, at substantially higher prices; while interrupted industries are in the process of being re-established, stocks, both of raw material and semi-manufactured articles, may have to be carried for longer periods than under normal conditions. There will be, moreover, in many of these industries, a more or less unproductive period by reason of the shortage of materials, during which standing charges will have to be provided for. This will vary, but it will obviously be greater in those industries which are subsidiary in the sense that the raw material required is the finished article in one or more previously applied manufacturing processes. This unproductive period will, in many cases, have to be bridged by means of increased financial facilities. We anticipate an increased demand for loans to meet the circumstances which we have just described, which are abnormal in character and unprecedented in dimensions.

6. The very great increase in the volume of production which has taken place—notably in the Engineering and Steel Trades—must also be taken into account. The increased demand for war material of all descriptions has resulted in the establishment of many entirely new firms, and necessitated very large extensions of plant and works on the part of established firms. The situation will, therefore, be complicated by the formation, in many industries, of an enlarged basis for a greatly increased commercial output compared with the pre-war output. This will necessitate seeking new markets and the establishment of new industries, and consequently an increased demand for credit facilities and additional capital.

Repairs and Renewals

7. The necessity for undertaking, at higher prices, repairs which have been in abeyance owing to the war and which are now much in arrear, constitutes a large item of expenditure which will affect industries at present engaged upon supplying the needs of the civil population, as well as those industries engaged upon war work.

General Character of the Demand

8. Owing to the unprecedented nature and dimensions of the change, the general character of the demand for assistance will differ from the demand in normal times, in that it will consist of a greater percentage of demand for loans secured upon capital goods (i.e. constructional material, etc.,) compared with loans secured upon consumable goods.

9. These demands may be summarized briefly as follows—

(*a*) For a considerable period after the war a greater demand for working capital, owing to the increased cost of labour and materials, the necessity for giving longer credit, and the anticipated expansion in the volume of trade.

(*b*) A greater demand for extended credits for the purpose of replacing, at higher cost, machinery and plant which has fallen into disrepair on account of the war.

(*c*) Requirements for re-conversion of plant and works which may, in many cases, be on the border line between working credit facilities and new capital requirements in respect of permanent outlay.

(*d*) New fixed capital requirements in respect of permanent outlay.

Ability to Meet Financial Requirements

10. It remains for us to consider the ability of trade and industry generally to meet their financial needs during the Reconstruction period. Some of our witnesses have given expression to fears of a general shortage in the supply of money and credit for financing post-war trade and industry. We think that these fears are exaggerated.

11. The ability to meet the requirements for the reconstruction of factories and works is dependent mainly upon the amount of reserves which it has

been possible to accumulate out of past profits. Speaking generally, in this connection trade and industry may be grouped into three main divisions.

12. In the first place, there is undoubtedly a large group of firms, previously established in various industries, who have been engaged upon the manufacture of war materials from a date soon after the commencement of the war. These firms have been able to do a very considerably increased amount of business, and have made large profits. In spite of the increased taxation, we think that a very large number of these firms will have been able to accumulate reserves sufficient for the needs of Reconstruction. Speaking of these established firms, the evidence submitted indicates that their financial position has improved to an extent which should enable them to raise any new capital which may be required, and to obtain from their bankers any increased facilities, which may be necessary during the Reconstruction period.

13. The second group consists of a number of firms who became engaged on war work at a later period of the war, when taxation was on a higher level, and the opportunity for accumulating reserves was, consequently, not so great. Many of these firms have been called upon to make large extensions to their works in order to cope with the increased demand for war material of every description. In cases where extensions have been made, we understand that, in the majority of instances these extensions have been written down to the estimated post-war value, to the controlled owner, and that the writing down has generally been on a liberal scale. Although it is true that, in many cases, this may result in the bulk of their liquid resources being locked up in bricks and mortar and fixed plant, it must also be taken into consideration that alteration by way of re-adaptation to a different class of output, or by way of reduction in size, is a much less expensive matter than an extension.

14. The third group comprises a number of entirely new firms, which have come into existence owing to the increasing demand for war material of all kinds, without any previous commercial history and with no trade or industry to which to revert after the war. From our own knowledge and experience, and from the evidence which has been placed before us, we are of opinion that the chief financial difficulties will be experienced in connection with this group. It has been urged upon us that it is not in the national interests that these firms should be allowed to peter out after the war, and that every inducement should be given them to continue in business and undertake commercial manufacture, if necessary even to the extent of granting them State financial assistance. We feel that, even if State financial aid is desirable, there are many difficulties in granting such aid. Apart from the fact that it might be regarded as unjust were these firms enabled, by means of State aid, to compete in established industries, with firms previously employed in the same industry, it will be difficult, if not impossible, to guard against wastefulness and inefficient management, and to ensure that the money was properly and economically employed.

The solution in these cases appears to us to lie, mainly, in the establishment of new industries. Everything will depend, however, upon the economic soundness of the industry undertaken, and the ability to meet and maintain the industry in the face of possible future competition. It is not possible to formulate any specific scheme for providing financial assistance for cases of this kind; the capital required for establishment of these industries must necessarily be furnished by the investor or by the individual partners engaged in the business. Each case must be judged on its individual merits, and the ability to attract the capital necessary for its establishment will depend upon the inherent soundness of the proposition and its future prospects.

Future Government Policy

15. An uncertain outlook for the future is one of the greatest deterrents to industry and finance alike. Whilst we recognize the difficulty at the present time of laying down in detail the future policy to be adopted in this

country in connection with trade and industry, there are certain questions upon which we think the Government might make known their policy at an early date. It would, undoubtedly, be of great assistance to manufacturers and others in laying down their plans for the future, if the policy to be adopted with regard to the following were made known—

(*a*) The future fiscal policy of this country.

(*b*) The rationing of raw materials, and priority of essential industries and urgent requirements.

(*c*) The break clause in connection with the termination of contracts for munitions of war.

(*d*) The disposal of State owned factories and surplus stores.

We have already drawn your attention, in a letter dated 1st November, 1918, to the necessity for immediate action in connection with the break clause. Judging by the evidence placed before us, there existed a great deal of apprehension with regard to the effect of these clauses. Stress was laid by witnesses, not only upon the dislocation and financial loss which would result from too sudden a termination of these contracts, but also upon the effect which such a step would have upon the labour market through a great number of hands being thrown out of employment. They urge the desirability of continuing contracts on a gradually reducing scale, rather than imposing an abrupt termination, wherever this can be done without serious economic objection. We understand that steps have been taken to encourage manufacturers to undertake commercial contracts as quickly as possible, and we think that, wherever possible, steps should also be taken to secure in advance adequate supplies of raw material for essential industries, either by immediate purchase or by forward contracts.

16. As the question of providing assistance for the reconstitution of the small one-man businesses is, we understand, under consideration by the Civil Liabilities Demobilization Committee, and the question of providing financial assistance for housing by the Housing (Financial Assistance) Committee, we consider these questions are outside the scope of our enquiry, and also that the question of providing financial assistance for the acquisition of land and the promotion of agriculture does not come within our terms of reference.

PART II

THE PROVISION OF FINANCIAL FACILITIES

The Credit System Before the War

17. To arrive at a correct understanding of the financial position after the war, it is necessary to describe, very briefly, the credit system before the war, and the changes which have occurred during the intervening period. In normal times, the necessity for maintaining an effective gold standard acted as an automatic check upon the undue expansion of credit. As the balance of indebtedness of this country with foreign countries became unfavourable and the exchanges moved against us, it became profitable to export gold to meet foreign claims. This export caused a gradual shrinkage in the available supplies, and the consequent reduction in the Bank of England ratio of reserve to liabilities, and so necessitated a rise in the Bank Rate, which, in turn, caused a general rise in interest rates. This rise in interest rates had a two-fold effect. In the first place, it attracted gold to this country and induced gold which otherwise would have been exported to remain, and, secondly, it induced people to pay off loans, and discouraged new loans being sought for and created. If the drain of gold was severe, money became " tight," and it became difficult to renew existing loans; this caused the sale of goods and produce upon which the loans were secured, and so brought about a fall in prices which encouraged exports and discouraged imports, and so gradually adjusted the situation.

18. But, apart from the external or international aspect, the internal currency also consisted of gold (or notes secured upon gold) which was the only legal tender for the settlement of debts. It is true that gold was unnecessary for the settlement of commercial transactions, and that the majority of these transactions were settled by cheques, but every depositor, with money lying to his credit at his bank on current account, besides the right of transferring the amount by cheque, had also the right, at any time, to withdraw the whole or any portion of the amount in gold. As the manufacture of Banking Credit by the process of granting loans also involves a corresponding increase in the deposit liabilities, the amount of additional loans which it was safe to grant had to bear a relation to the supply of, and possible demand for, gold.

19. There was also the further check that whilst a great expansion of credits caused an increased activity in trade it also caused a rise in the price of commodities, owing to the increased competitive demand due to the creation of additional purchasing power; this in turn caused a rise in wages, and so, in one way or another, brought about an increased demand for gold for currency purposes, which resulted in a larger amount remaining in circulation with a consequent reduction in the reserves. This set of circumstances thus acted in the same manner as an adverse foreign exchange, and brought into play the same remedial measures.

20. It will be seen, therefore, that the gold standard not only maintained the whole financial structure in a state of equilibrium, but through finance, it exerted a powerful influence upon, and kept the general level of domestic prices in equilibrium with gold or world prices. It acted as a wholesome restraint upon overtrading, and often adjusted situations which, had they remained unchecked, might have developed into severe commercial crises.

The Position To-Day

21. Owing to the war, the conditions prevailing to-day are entirely different. There is no free international market in gold, the natural operation of the foreign exchanges has been interrupted, and the internal gold circulation has been replaced by a Currency Note issue. There is no legal limit to the amount of Currency Notes which may be issued, and there is, therefore, no automatic check upon the expansion of credit.

22. The total deposits of the Banks of the United Kingdom (other than the Bank of England), which amounted on the 31st December, 1913, to £1,070,000,000, are now approaching £2,000,000,000. These figures are an indication of the very great expansion of credit which has taken place up to the present time, and which still remains unchecked. The enormously increased purchasing power thus created has, in our opinion, been one of the main factors contributing to the rise in prices which has taken place.

The Position After the War

23. The financial situation during the Reconstruction period will be influenced profoundly by the prevailing financial conditions at the termination of the war. Having regard to the fact that the very great expansion in credits which has taken place during the war, will probably persist for a considerable period after its termination, we are unanimously of opinion that, if the reconstitution of Industry and Commerce is to be achieved, on permanent and sound economic lines, some restriction must be imposed, at as early a date as possible, upon the creation of additional credit by the restoration of an effective gold standard. To attempt to rebuild Industry by means of a further indiscriminate expansion of credit, would not only endanger our position as the financial centre of the world, but would inevitably lead before long to grave disaster.

24. For this reason we think that State borrowing should cease as soon as possible after the conclusion of the war. It must be borne in mind that new

Commercial Capital issues have been largely in abeyance since the commencement of the war, and that, consequently, there will be a great demand from Trade and Industry for additional capital. State borrowing can only be undertaken in competition with these demands. We are also of opinion that any Government guarantee to bankers to enable them to provide, by means of credit, for fixed capital expenditure necessary for the reconstitution of industry, is undesirable as being likely to cause a further expansion of credit together with an additional rise in prices.

25. On the contrary, we believe that the restoration of sound financial methods will necessitate the institution, at an early date, of measures to reduce gradually the undesirable credit inflation arising out of the present enormous volume of short-dated Government debt, and that it will be necessary for the State to undertake funding operations for this purpose.

26. The objects to be aimed at in order to achieve the reconstitution of Industry on sound financial and economic lines may be summarized briefly as follows—

(1) To re-establish a sound financial basis by means of an effective gold standard;

(2) To check any undue expansion of credit which can only be reflected by a further rise in prices;

(3) To take steps to reduce to more normal proportions the inflation of credit due to the war.

Banking Facilities

27. By Banking Facilities we mean the normal requirements for carrying on the ordinary business of the country which assumes the granting of loans which do not constitute a lock-up of funds such as would impair the liquidity of the resources of the banks.

28. In order to obtain from bankers themselves an opinion as to the ability of the banks to meet these demands, a meeting of representatives of the London Clearing Banks was held on 20th June, 1918, under the auspices of our Chairman, at which the representative of the Country Bankers' Association and others were also present. This meeting was unanimously of opinion that the banks would be able to provide all the facilities of this character required by trade and industry during the transition period. In addition to this, banking witnesses have given evidence before us, and we have also examined evidence given by similar witnesses before the Committee on Financial Risks attaching to the holding of Trading Stocks. From the evidence thus submitted to us, we are of opinion that, so far as demands of this character are concerned, the situation may be left safely in the hands of the banks.

Extended Credit Facilities

29. By Extended Credit Facilities we mean loans involving a lock-up of funds for a more or less extended period and secured upon assets not readily realizable, including loans required for giving "long trading" credit, either at home or abroad, and loans secured against capital goods which are either dependent upon future profits for repayment, or will be replaced ultimately by an issue of new capital. The provision of adequate facilities of this character, if the demand be upon a great scale, which in many quarters is thought will be the case, presents one of the chief difficulties with which we have to deal. It is clear that the banks, as at present constituted, however willing they may be, will only be able to assist in a limited degree, owing to the necessity for keeping a large proportion of their funds in a liquid state.

30. We have already stated (pars. 5–9) that, in our judgment, the character of the demand for assistance during the Reconstruction period will differ from that of normal times. This difference is likely to be of a temporary nature. To meet these demands, we are of opinion that, in the first place,

the banks will, for the time being, have to depart in a measure from traditional customs when judging the character of the risk involved. It will be necessary to exercise discretion upon rather broader lines. And secondly, to enable them to do this with greater safety and confidence, we are strongly of opinion that a substantial increase in their paid-up capital is desirable. Apart from the necessity for being in the strongest possible position to meet the demands which we have foreshadowed, such a measure is in our opinion also necessary, to enable the banks to grant the extended credit and generally wider facilities which will be required in the future, if trade and industry is to be in a position to compete successfully with the foreigner. Moreover, in view of the decline in recent years of the ratio of paid-up capital and reserves to deposit liabilities, an increase is eminently desirable. From the evidence which has been placed before us, and from the trend of recent events in the banking world, we believe that bankers themselves are, generally speaking, agreed upon the desirability of this increase. We recommend, therefore, that every facility should be given by the Government to enable the issue, at the earliest possible moment, of any new share capital which may be found necessary.

31. During the period immediately following the war it is essential that the available supply of capital and credit should be devoted in the first place to the assistance of the most urgent national needs for production, and, whilst it will be necessary for the banks to take a liberal view of the requests for loans, we think that, in order to check any outburst of speculation and prevent the inception of enterprises of an unessential character, it will also be necessary to exercise some discretion as to the purpose for which the money is required. The rationing of the available supplies of raw material, if it be found necessary, will furnish a measure of guidance in this connection.

32. To enable the banks to do more in the direction of granting long trading credits, we are also of opinion that it is desirable that bankers should make more widely known their willingness to accept deposits for long periods, at fixed rates of interest. We believe that, if they were encouraged to do so, a number of depositors would be willing to deposit their money at fixed rates of interest, for periods of from one to five years, without the right of withdrawal. The removal of the liability to withdrawal would thus enable the banks to grant loans for longer periods.

33. In the foregoing paragraphs we have recommended the only practical remedies which appear to us to be possible at the present time. It must, however, be borne in mind that the efficient organization of trade and industry on up-to-date lines is, in itself, an important factor when considering financial assistance. We welcome, therefore, the policy of trade organization and co-operation which has recently become manifest, as furnishing greater financial security, and a sounder basis for the granting of credit facilities. A well balanced capital account without an undue proportion of debenture debt compared with the share capital is also of the greatest importance when considering long credits. It is obvious that a bank cannot be expected to take the risk of advancing money for long periods in cases where there is already a prior lien upon the assets in the form of a large debenture issue.

The principal manufacturing establishments of this country (although their capitals are small compared with those of Germany and the United States) are now organized on a joint stock basis, and have access through their shareholders (who, in individual cases, number many thousands) to the source from which new capital can be obtained. The war has placed them, generally speaking, in a position where issues of new capital are likely to be well responded to; and we suggest that they should, by increasing their capitals—thereby increasing their available resources not only by the increased capital itself but also by the improved credit facilities which it will enable them to command—put themselves in a stronger position to meet the hoped for extension of production, to carry stocks abroad, to furnish longer credits to their customers where necessary and advisable, and to take a part in the

financing of large contracts which they may obtain for their manufactures, either within the Empire or elsewhere.

Additional capital so raised would also enable leading concerns to develop new lines of enterprise, more or less allied to their existing business, with much less risk and more prospect of ultimate success than by the formation of new and independent concerns.

If a portion of any such issue of shares of a preferential character, and giving a good return in dividends, were reserved for their workpeople, it would materially assist financially and in other equally important directions.

34. In our opinion, institutions are necessary to provide additional assistance for trade and industry by developing similar facilities to those which have been provided by the German banks. In this connection we have to notice the formation of the British Trade Corporation. This institution was formed as a result of the deliberations of the Committee appointed by the Board of Trade to investigate the question of Financial Facilities for Trade. Its constitution and functions were laid down by the Committee as follows—

(1) It should have a capital of £10,000,000. The first issue should be from £2,500,000 to £5,000,000, upon which, in the first instance, only a small amount should be paid up, but which should all be called up within a reasonable time. A further issue should be made afterwards, if possible, at a premium.

(2) It should not accept deposits at call or short notice.

(3) It should only open current accounts for parties who are proposing to make use of the overseas facilities which it would afford.

(4) It should have a Foreign Exchange Department where special facilities might be afforded for dealing with bills in foreign currency.

(5) It should open a Credit Department for the issue of credits to parties at home and abroad.

(6) It should enter into banking agency arrangements with existing Colonial or British-foreign banks wherever they could be concluded upon reasonable terms, and where such arrangements were made, it should undertake not to set up for a specified period its own branches or agencies. It should have power to set up branches or agencies where no British-foreign bank of importance exists.

(7) It should inaugurate an Information Bureau.

(8) It should endeavour not to interfere in any business for which existing banks and banking houses now provide facilities, and it should try to promote working transactions on joint account with other banks, and should invite other banks to submit to it new transactions which, owing to length of time, magnitude, or other reasons they are not prepared to undertake alone.

(9) Where desirable, it should co-operate with the merchant and manufacturer, and possibly accept risks upon joint account.

(10) It should become a centre for syndicate operations, availing itself of the special knowledge which it will possess through its Information Bureau.

35. We have had the advantage of an interview with Lord Faringdon, Chairman of the above-mentioned Committee, and now Governor of the British Trade Corporation. Lord Faringdon explained the work which will be undertaken, and gave us particulars of some of the plans which have been laid down for the future. The Corporation was designed to fill a gap in the financial machinery of this country and to supply needs which have long been felt by trade and industry. Apart from the assistance which it will be able to render in connection with overseas contracts, the development of existing markets, and the securing of new ones, its sphere of usefulness is large, and one of great importance to the development of trade and industry.

But, as the business which the Corporation was formed to undertake exists to-day only to a limited extent, owing to the restrictions imposed upon

trade in consequence of the war, it is difficult for us to estimate either the volume of demands which will be made upon it, or its competency to meet them in their entirety. Obviously its power to do so will be limited by the means now at its disposal and by its ability to raise additional capital. Additional institutions of this character may be required in the future. The Corporation has, however, not yet had adequate opportunity for demonstrating its usefulness, which we believe will be great, and is not yet firmly established as an integral part of our financial machinery.

36. Several suggestions have been laid before us for the formation of Trade Banks or Co-operative Credit Associations of other types than those already referred to, but after careful consideration of all the circumstances we have come to the conclusion that it will be better to utilize the machinery already available rather than to create now, to meet a set of unknown circumstances, new types of institutions.

New Issues

37. We have already alluded to the fact that commercial issues of new capital having been largely in abeyance since the commencement of the war, it is reasonable to expect a very large number of appeals for new capital, and that if the State is also under the necessity of borrowing, it will create a further element of competition which is likely to force up money rates to a high level. But it is also most essential for the future prosperity of this country that the available supply of capital should flow, in the first place, to essential industries, and not to the support of enterprises of a speculative or unessential character. The increased cost of living and high taxation will induce many people to seek a high return on their capital with less consideration for safety, and will, consequently, encourage the issue of enterprises of the latter character. Whilst we are in favour of an early removal of all measures of State control of finance and industry alike, at the same time we are of opinion that it will be advisable to maintain, after the war, some control over new issues, at any rate until such time as State borrowing in connection with the war is completed.

For these reasons we are also of opinion that it will be necessary for the same period to exercise, as far as possible, supervision over the export of capital, and the objects for which such export may be desired. Apart, however, from control of new issues during the reconstruction period, we are of opinion it is most desirable that, if possible, permanent measures should be taken to prevent, or make more difficult, the promotion and issue of unsound propositions. Consideration of the subject in this wider aspect does not come within the scope of our inquiry, but we think it might be possible to strengthen the Companies Acts so as to achieve this purpose, and we hope that this may be carried out.

38. We are impressed by the enormous potential increase in the number of small investors, which is shown by the figures published by the National War Savings Committee. The continuance on the part of the people of this country of the habit of investing their savings constitutes a most important factor in the provision of the capital necessary for the rapid re-conversion of trade and industry.

The destruction of capital during the war can only be made good by genuine saving. An increase in the habit of saving on the part of the community in general means an increase in the real capital wealth of the country which is bound to benefit trade and industry.

It is impossible to over-estimate the value of the work done by the National War Savings Association throughout the country in encouraging habits of thrift and economy. Government securities furnish by far the best and safest medium for the investment of small sums of money, and we are glad to notice that steps are to be taken, by means of Savings Associations, to continue the policy which has proved so successful during the war.

39. The provision of the capital required for the re-conversion of trade and industry is dependent largely upon the machinery for promoting enterprises,

and offering for public subscription new issues of capital which will be required by commercial and industrial concerns. In Germany, the great banks undertook a large amount of this class of business; they were willing to take a hand in any promising industrial enterprise, and furnish money at an early stage in its career, ultimately, if the concern proved successful, themselves making the issue to the public. For this purpose, and in order to spread the risk during the initiatory stages, they surrounded themselves with a secondary group of industrial banks, syndicates, etc., who participated with them in the business. There were many advantages in this system. In the first place, a channel was provided through which the business could flow, and, secondly, the customer of the bank was able, through the branch of his own bank, to obtain an opinion upon any enterprise, or contemplated extension to his works or business, without having to go further afield, and this, too, with the additional knowledge that if his project was a sound one, he would receive their assistance in raising the necessary capital.

40. A second important point is that the German method furnished a greater degree of protection to the investor, as the banks were in a measure responsible for the *bonâ fides* and sound character of the proposition. This led to a more careful examination of the prospects, and ensured that enterprises were not offered for public subscription until they were more or less found to be successful as going concerns. There is also the further substantial advantage that the bank was able to maintain a measure of control through the banking account of the business, and thus was able to prevent over-trading, and ensure that the business was conducted on sound lines.

41. We do not suggest that the deposit banks in this country should adopt the German method of conducting this class of business. We believe that the machinery, to which the British Trade Corporation should form a valuable addition, is already in existence. It consists of a group of financial houses, comprising investment trust companies, well-known issuing houses, merchant bankers, and others. There will be many openings in this country, after the war, for the remunerative employment of capital. We think that it is within the power of this important group, without neglecting enterprises abroad which would be likely to be advantageous to trade, to render further assistance, by identifying themselves with productive industries in this country and rendering financial support in the earlier stages of development, ultimately undertaking the placing of the issue of new capital with the investor.

42. The institution of a system of working arrangements between the members of this group and the various Joint Stock Banks would, we think, be of great assistance. It would form a well-defined channel through which the business could flow and would combine, on the one hand, the knowledge gained by the bank of the past history, integrity, and ability of the customer, and, on the other hand, the financial knowledge and experience of the trust company or issuing house. And further, if means can be devised by which the banks can undertake some responsibility for the *bonâ fides*, not necessarily the future success, of the undertakings on behalf of which they agree to accept subscriptions, it will add a very considerable measure of protection to the investor.

State Aid

43. We have considered carefully the necessity for State aid, more particularly as applied to banking. We have discussed schemes for the issue of industrial securities, guaranteed by the Government wholly or partially, as to interest only and as to both principal and interest, and also the possibility of making direct advances to individual firms. We have already stated (par. 24) that we do not recommend any assistance to bankers; and in paragraph 14 we have discussed the difficulty of granting such aid to individual firms. Speaking generally, State aid by means of advances implies also a

measure of State control. From the evidence that has been placed before us, we believe that manufacturers and traders are unanimously in favour of the removal of all State control of industry at as early a date as possible. This being the case, it is clear that applications for assistance by means of a loan from Government would only be made after refusal in other quarters. Obviously, the majority of applications would, therefore, be an invitation for the State to step in where experts had already refused, and would hardly form suitable investments for public funds.

44. We think, however, that cases of hardship may arise, more particularly in connection with firms who have undertaken, under considerable pressure from the Government, the manufacture of munitions of war. This hardship is likely to be accentuated in cases where a great change in plant or the building of large extensions has been necessary. It is possible that, in many cases, owing to high taxation and other causes, the full significance of the change and the expenditure necessary for re-conversion of plant and machinery has not been realized by the manufacturers in question, actuated as they may have been by patriotic motives or under pressure from a Government Department. We think that it is only just that the Government should give sympathetic consideration in all such cases. We do not think it is possible to design any scheme for dealing with them on general lines, either by means of loans or otherwise.

45. We understand, however, that individual cases already receive sympathetic treatment at the hands of the Departments; but we are of opinion that it would facilitate the investigation of them, and create an additional measure of confidence, if a small Committee were formed, consisting of Government officials and business men in leading industries, either to consider them in the first instance, or to act as a Tribunal, to which appeal could be made when the applicant considered that he had not received adequate consideration at the hands of the State.

46. Circumstances may arise in connection with certain key industries, which will necessitate the granting of State financial assistance in some form or another. It may be that the issue of securities with some form of a Government guarantee will be found to be the best means of raising the necessary capital in cases of this character; but we do not think this method could be adopted with advantage as a means of assisting the ordinary commercial and manufacturing enterprises in this country.

47. It has been urged upon us that the present high rate of Excess Profits Duty has prevented the formation of adequate reserves, and has resulted in many cases in the depletion of the liquid resources necessary to furnish working capital and provide for re-conversion expenditure during the Reconstruction period. Whilst this subject is under more intimate consideration by the Committee on Financial Risks attaching to the holding of Trading Stocks, we are of opinion that it would be of great assistance to manufacturers and others, who find themselves in this position, if arrangements can be made by which a portion of the tax can be retained for a period in the form of a loan. The rate of interest to be charged, and the terms and conditions upon which it is granted, whilst not of a penal character, such as might render the concession useless, should be so framed as to secure early repayment, protect the Government from loss, and prevent applications of a frivolous nature.

SUMMARY

Part I

48. Our recommendations and main conclusions may be summarized briefly as follows—

There will be an increased demand for credit facilities during the Reconstruction period. The character of the demand will also differ from that of

normal times in that it will consist of a greater demand for loans secured upon capital goods compared with loans secured upon consumable goods. (Pars. 5–9.)

The ability of trade and industry generally to provide for its financial needs will depend largely upon the amount of reserves it has been possible to accumulate. There are three main divisions under this head—

(*a*) Firms who have been engaged upon war work from a date soon after the commencement of the war.

(*b*) Firms who became engaged upon war work at a later period of the war.

(*c*) New firms created as a result of the enormously increased demand for war material of all descriptions.

We anticipate the chief financial difficulties will be in connection with the third group. (Pars. 10–14.)

Uncertainty being the greatest deterrent to Industry and Finance alike, it is important that the Government should pronounce their future policy with regard to—

(*a*) The future fiscal policy of this country;

(*b*) The rationing of raw materials and priority of essential industries and urgent requirements;

(*c*) The break clause in connection with the termination of contracts for munitions of war;

(*d*) The disposal of State owned factories and surplus stores. (Par. 15.)

Part II

In paragraphs 17–25 we discuss the Credit System. To achieve the reconstitution of trade and industry on sound financial and economic lines it will be necessary—

(*a*) To re-establish a sound financial basis by means of an effective gold standard;

(*b*) To check any undue expansion of credit, which can only be reflected by a further rise in prices;

(*c*) To take steps to reduce to more normal proportions the inflation of credit due to the war. (Par. 26.)

The banks will be in a position to meet demands for ordinary banking facilities. (Pars. 27–28.)

There will be some difficulty in providing all the extended credit facilities which may be required. (Par. 29.)

To meet this difficulty we recommend—

(*a*) An increase in the capital of the banks. (Par. 30.)

(*b*) The acceptance by the banks of deposits for longer periods at fixed rates of interest. (Par. 32.)

(*c*) The strengthening of industrial concerns by increase of share capital. (Par. 33.)

(*d*) In paragraphs 34–35 we discuss the formation of the British Trade Corporation, which we believe will be of great assistance to trade and industry. Additional institutions of a similar character may be necessary in the future.

It will be necessary, when dealing with applications for loans, for the banks to exercise discretion on broad lines when judging the character of the risk, but it will also be necessary, in order to check the inception of speculative enterprises of an unessential character, to exercise some discrimination as to the purpose for which the money is required. (Pars. 30–31.)

In order that enterprises of national importance may have the first call upon the available supply of capital, it is desirable to maintain, for a period after the war, supervision over new issues and over the export of capital. (Par. 37.)

To provide capital necessary for re-conversion, it is important that the habit of saving should be encouraged. (Par. 38.)

It is desirable to improve the machinery for the promotion and issue of commercial and industrial enterprises. We recommend for this purpose—

(*a*) Working arrangements between the banks and the large financial group comprising the investment trust companies, issuing houses, etc ; and

(*b*) It will also furnish greater protection to the investor if the banks can undertake some responsibility for the *bonâ fides* of undertakings on behalf of which they agree to accept subscriptions. (Pars. 39–42.)

In paragraphs 43–47 we discuss the question of State aid to industry. We recommend—

(*a*) The formation of a Committee to deal with cases of hardship arising out of contracts for munitions (par. 45) ; and

(*b*) It would be of assistance to manufacturers and others if arrangements can be made by which a portion of the Excess Profits Duty can be retained for a period in the form of a loan. (Par. 47.)

49. We desire to place upon record our deep sense of the obligation we are under to our Secretary, Mr. R. C. Smallwood, for his assistance in obtaining evidence and in the preparation of our Report.

We have the honour to be,
My Lords and Sir,
Your obedient Servants,

(Signed) R. V. VASSAR-SMITH (*Chairman*).
JOHN BRADBURY.
ALAN E. L. CHORLTON.
EDWARD B. FIELDEN.
ALGERNON F. FIRTH.
ROBERT FLEMING.
ARTHUR C. D. GAIRDNER.
F. C. GOODENOUGH.
H. C. HAMBRO.
ALEXANDER ROGER.
JOHN SAMPSON.
A. W. TAIT.

R. C. SMALLWOOD (Secretary).
21st November, 1918.

APPENDIX X

FIRST INTERIM REPORT OF THE COMMITTEE ON CURRENCY AND FOREIGN EXCHANGES AFTER THE WAR

TERMS OF APPOINTMENT

THE Lords Commissioners of His Majesty's Treasury and the Minister of Reconstruction have appointed a Committee to consider the various problems which will arise in connection with currency and the foreign exchanges during the period of reconstruction and report upon the steps required to bring about the restoration of normal conditions in due course.

The constitution of the Committee will be as follows—

LORD CUNLIFFE, G.B.E., Governor of the Bank of England, *Chairman*.
SIR CHARLES ADDIS, Hong-Kong and Shanghai Banking Corporation.
THE HON. RUPERT BECKETT, Beckett and Company.
SIR JOHN BRADBURY, K.C.B., Secretary to the Treasury.
G. C. CASSELS, Esq., Bank of Montreal.
GASPARD FARRER, Esq., Baring and Company.
THE HON. HERBERT GIBBS, Antony Gibbs and Sons.
W. H. N. GOSCHEN, Esq., Chairman of the Clearing Bankers' Committee.

LORD INCHCAPE OF STRATHNAVER, G.C.M.G., K.C.S.I., K.C.I.E.
R. W. JEANS, Esq., Bank of Australasia.
A. C. PIGOU, Esq., M.A., Professor of Political Economy, Cambridge University.
G. F. STEWART, Esq., D.L., F.S.I., Ex-Governor of the Bank of Ireland.
WILLIAM WALLACE, Esq., Royal Bank of Scotland.
MR. G. C. UPCOTT, of the Treasury and Ministry of Reconstruction, will act as Secretary to the Committee.

January, 1918.

The following words were subsequently added to the Terms of Reference—

" and to consider the working of the Bank Act, 1844, and the constitution and functions of the Bank of England with a view to recommending any alterations which may appear to them to be necessary or desirable."

To the Lords Commissioners of His Majesty's Treasury and the Minister of Reconstruction.

INTRODUCTION

MY LORDS AND SIR,

1. We have the honour to present herewith an interim Report on certain of the matters referred to us in January last. In this Report we attempt to indicate the broad lines on which we think the serious currency difficulties which will confront this country at the end of the war should be dealt with. The difficulties which will arise in connection with the Foreign Exchanges will be no less grave, but we do not think that any recommendations as to the emergency expedients which may have to be adopted in the period immediately following the conclusions of peace can usefully be made until the end of the war is clearly in sight and a more definite opinion can be formed as to the conditions which will then prevail. We propose also to deal in a later Report with questions affecting the constitution and management of the Bank of England, and with the applicability of the recommendations contained in this Report to Scotland and Ireland, in regard to which we have not yet taken evidence. We have therefore confined our inquiry for the present to the broad principles upon which the currency should be regulated. We have had the advantage of consultation with the Bank of England, and have taken oral evidence from various banking and financial experts, representatives of certain Chambers of Commerce and others who have particularly interested themselves in these matters. We have also had written evidence from certain other representatives of commerce and industry. Our conclusions upon the subjects dealt with in this Report are unanimous, and we cannot too strongly emphasize our opinion that the application, at the earliest possible date, of the main principles on which they are based is of vital necessity to the financial stability and well being of the country. Nothing can contribute more to a speedy recovery from the effects of the war, and to the rehabilitation of the foreign exchanges, than the re-establishment of the currency upon a sound basis. Indeed, a sound system of currency will, as is shown in paragraphs 4 and 5, in itself secure equilibrium in those exchanges, and render unnecessary the continued resort to the emergency expedients to which we have referred. We should add that in our inquiry we have had in view the conditions which are likely to prevail during the ten years immediately following the end of the war, and we think that the whole subject should be again reviewed not later than the end of that period.

THE CURRENCY SYSTEM BEFORE THE WAR.

2. Under the Bank Charter Act of 1844, apart from the fiduciary issue of the Bank of England and the notes of Scottish and Irish Banks of Issue,

(which were not actually legal tender), the currency in circulation and in Bank reserves consisted before the war entirely of gold and subsidiary coin or of notes representing gold. Gold was freely coined by the Mint without any charge. There were no restrictions upon the import of gold. Sovereigns were freely given by the Bank in exchange for notes at par value, and there were no obstacles to the export of gold. Apart from the presentation for minting of gold already in use in the arts (which under normal conditions did not take place) there was no means whereby the legal tender currency could be increased except the importation of gold from abroad to form the basis of an increase in the note issue of the Bank of England or to be presented to the Mint for coinage, and no means whereby it could be diminished (apart from the normal demand for the arts, amounting to about £2,000,000 a year, which was only partly taken out of the currency supply) except the export of bullion or sovereigns.

3. Since the passing of the Act of 1844 there has been a great development of the cheque system. The essence of that system is that purchasing power is largely in the form of bank deposits operated upon by cheque, legal tender money being required only for the purpose of the reserves held by the banks against those deposits and for actual public circulation in connection with the payment of wages and retail transactions. The provisions of the Act of 1844 as applied to that system have operated both to correct unfavourable exchanges and to check undue expansions of credit.

4. When the exchanges were favourable, gold flowed freely into this country and an increase of legal tender money accompanied the development of trade. When the balance of trade was unfavourable and the exchanges were adverse, it became profitable to export gold. The would-be exporter bought his gold from the Bank of England and paid for it by a cheque on his account. The Bank obtained the gold from the Issue Department in exchange for notes taken out of its banking reserve, with the result that its liabilities to depositors and its banking reserve were reduced by an equal amount, and the ratio of reserve to liabilities consequently fell. If the process was repeated sufficiently often to reduce the ratio in a degree considered dangerous, the Bank raised its rate of discount. The raising of the discount rate had the immediate effect of retaining money here which would otherwise have been remitted abroad and of attracting remittances from abroad to take advantage of the higher rate, thus checking the outflow of gold and even reversing the stream.

5. If the adverse condition of the exchanges was due not merely to seasonal fluctuations, but to circumstances tending to create a permanently adverse trade balance, it is obvious that the procedure above described would not have been sufficient. It would have resulted in the creation of a volume of short-dated indebtedness to foreign countries which would have been in the end disastrous to our credit and the position of London as the financial centre of the world. But the raising of the Bank's discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed and the demand for constructional materials and other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried largely with borrowed money, being confronted with an increase of interest charges, if not with actual difficulty in renewing loans, and with the prospect of falling prices, tended to press their goods on a weak market. The result was a decline in general prices in the home market which, by checking imports and stimulating exports, corrected the adverse trade balance which was the primary cause of the difficulty.

6. When apart from a foreign drain of gold, credit at home threatened to become unduly expanded, the old currency system tended to restrain the expansion and to prevent the consequent rise in domestic prices which

ultimately causes such a drain. The expansion of credit, by forcing up prices, involves an increased demand for legal tender currency both from the banks in order to maintain their normal proportion of cash to liabilities and from the general public for the payment of wages and for retail transactions. In this case also the demand for such currency fell upon the reserves of the Bank of England, and the Bank was thereupon obliged to raise its rate of discount in order to prevent the fall in the proportion of that reserve to its liabilities. The same chain of consequences as we have just described followed and speculative trade activity was similarly restrained. There was therefore an automatic machinery by which the volume of purchasing power in this country was continuously adjusted to world prices of commodities in general. Domestic prices were automatically regulated so as to prevent excessive imports; and the creation of banking credit was so controlled that banking could be safely permitted a freedom from State interference which would not have been possible under a less rigid currency system.

7. Under these arrangements this country was provided with a complete and effective gold standard. The essence of such a standard is that notes must always stand at absolute parity with gold coins of equivalent face value, and that both notes and gold coins stand at absolute parity with gold bullion. When these conditions are fulfilled, the foreign exchange rates with all countries possessing an effective gold standard are maintained at or within the gold specie points.

Changes which have Affected the Gold Standard during the War

8. It will be observed that the fall in a number of the foreign exchanges below the old export specie points which has taken place since the early part of 1915[1] is not by itself a proof that the gold standard has broken down or ceased to be effective. During the present war the depredations of enemy submarines, high freights, and the refusal of the Government to extend State insurance to gold cargoes have greatly increased the cost of sending gold abroad. The actual export specie point has, therefore, moved a long way from its old position. In view of our enormous demands for imports, coupled with the check on our exports due to the war, it was natural that our exchanges with neutrals should move towards the export specie point. Consequently, the fall in the export specie point would by itself account for a large fall in our exchange rates. Such a fall must have taken place in the circumstances, even though all the conditions of an effective gold standard had been fully maintained.

9. The course of the war has, however, brought influences into play in consequence of which the gold standard has ceased to be effective. In view of the crisis which arose upon the outbreak of war it was considered necessary, not merely to authorize the suspension of the Act of 1844, but also to empower the Treasury to issue Currency Notes for one pound and for ten shillings as legal tender throughout the United Kingdom. Under the powers given by the Currency and Bank Notes Act, 1914, the Treasury undertook to issue such notes through the Bank of England to bankers, as and when required, up to a maximum limit not exceeding for any bank 20 per cent. of its liabilities on current and deposit accounts. The amount of notes issued to each bank was to be treated as an advance bearing interest at the current Bank Rate.

10. It is not likely that the internal demand for legal tender currency which was anticipated at the beginning of August, 1914, would by itself have necessitated extensive recourse to these provisions. But the credits created by the Bank of England in favour of its depositors under the arrangements by which the Bank undertook to discount approved bills of exchange

[1] In the abnormal circumstances at the outbreak of war the neutral exchanges moved temporarily in our favour owing to the remittance home of liquid balances from foreign countries and the withdrawals of foreign credits.

and other measures taken about the same time for the protection of credit caused a large increase in the deposits of the Bank. Further, the need of the Government for funds wherewith to finance the war in excess of the amounts raised by taxation and by loans from the public has made necessary the creation of credits in their favour with the Bank of England. Thus, the total amount of the Bank's deposits increased from, approximately, £56,000,000 in July, 1914, to £273,000,000 on the 28th July, 1915, and, though a considerable reduction has since been effected, they now (15th August) stand as high as £171,870,000. The balances created by these operations passing by means of payments to contractors and others to the Joint Stock Banks have formed the foundation of a great growth of their deposits, which have also been swelled by the creation of credits in connection with the subscriptions to the various War Loans.[1] Under the operation of these causes the total deposits of the banks of the United Kingdom (other than the Bank of England) increased from £1,070,681,000 on the 31st December, 1913, to £1,742,902,000 on the 31st December, 1917.

11. The greatly increased volume of bank deposits, representing a corresponding increase of purchasing power and, therefore, leading in conjunction with other causes to a great rise of prices, has brought about a corresponding demand for legal tender currency which could not have been satisfied under the stringent provisions of the Act of 1844. Contractors are obliged to draw cheques against their accounts in order to discharge their wages bill—itself enhanced on account of the rise of prices. It is to provide this currency that the continually growing issues of Currency Notes have been made. The banks, instead of obtaining notes by way of advance under the arrangements described in paragraph 9, were able to pay for them outright by the transfer of the amount from their balances at the Bank of England to the credit of the Currency Note Account and the circulation of the notes continued to increase. The Government subsequently, by substituting their own securities for the cash balance so transferred to their credit, borrow that balance. In effect, the banks are in a position at will to convert their balances at the Bank of England enhanced in the manner indicated above into legal tender currency without causing notes to be drawn, as they would have been under the pre-war system, from the banking reserve of the Bank of England, and compelling the Bank to apply the normal safeguards against excessive expansion of credit. Fresh legal tender currency is thus continually being issued, not, as formerly, against gold, but against Government securities. Plainly, given the necessity for the creation of bank credits in favour of the Government for the purpose of financing war expenditure, these issues

[1] This process has had results of such far-reaching importance that it may be useful to set out in detail the manner in which it operates. Suppose, for example, that in a given week the Government require £10,000,000 over and above the receipts from taxation and loans from the public. They apply for an advance from the Bank of England, which by a book entry places the amount required to the credit of Public Deposits in the same way as any other banker credits the account of a customer when he grants him temporary accommodation. The amount is then paid out to contractors and other Government creditors, and passes, when the cheques are cleared, to the credit of their bankers in the books of the Bank of England—in other words, is transferred from Public to "Other" Deposits, the effect of the whole transaction thus being to increase by £10,000,000 the purchasing power in the hands of the public in the form of deposits in the Joint Stock Banks and the bankers' cash at the Bank of England by the same amount. The bankers' liabilities to depositors having thus increased by £10,000,000 and their cash reserves by an equal amount, their proportion of cash to liabilities (which was normally before the war something under 20 per cent.) is improved, with the result that they are in a position to make advances to their customers to an amount equal to four or five times the sum added to their cash reserves, or, in the absence of demand for such accommodation to increase their investments by the difference between the cash received and the proportion they require to hold against the increase of their deposit liabilities. Since the outbreak of war it is the second procedure which has in the main been followed, the surplus cash having been used to subscribe for Treasury Bills and other Government securities. The money so subscribed has again been spent by the Government and returned in the manner above described to the bankers' cash balances, the process being repeated again and again until each £10,000,000 originally advanced by the Bank of England has created new deposits representing new purchasing power to several times that amount. Before the war these processes, if continued, compelled the Bank of England, as explained in paragraph 6, to raise its rate of discount, but, as indicated below, the unlimited issue of Currency Notes has now removed this check upon the continued expansion of credit.

could not be avoided. If they had not been made, the banks would have been unable to obtain legal tender with which to meet cheques drawn for cash on their customers' accounts. The unlimited issue of Currency Notes in exchange for credits at the Bank of England is at once a consequence and an essential condition of the methods which the Government have found necessary to adopt in order to meet their war expenditure.

12. The effect of these causes upon the amount of legal tender money (other than subsidiary coin) in bank reserves and in circulation in the United Kingdom are shown in the following paragraph—

13. The amounts on the 30th June, 1914, may be estimated as follows—

Fiduciary Issue of the Bank of England . . .	£18,450,000
Bank of England Notes issued against gold coin or bullion.	£38,476,000
Estimated amount of gold coin held by banks (excluding coin held in the Issue Department of the Bank of England) and in public circulation . . .	£123,000,000
Grand Total	£179,926,000

The corresponding figures on the 10th July, 1918, as nearly as they can be estimated, were—

Fiduciary Issue of the Bank of England . . .	£18,450,000
Currency Notes not covered by gold	£230,412,000
Total Fiduciary Issues[1]	£248,862,000
Bank of England Notes issued against coin and bullion .	£65,368,000
Currency Notes covered by gold	£28,500,000
Estimated amount of gold coin held by banks (excluding gold coin held by Issue Department of Bank of England), say	£40,000,000
Grand Total	£382,730,000

There is also a certain amount of gold coin still in the hands of the public which ought to be added to the last-mentioned figure, but the amount is unknown.

14. As Bank of England Notes and Currency Notes are both payable at the Bank of England in gold coin on demand this large issue of new notes, associated as it is with abnormally high prices and unfavourable exchanges, must have led under normal conditions to a rapid depletion, threatening ultimately the complete exhaustion, of the Bank's gold holdings. Consequently, unless the Bank had been prepared to see all its gold drained away, the discount rate must have been raised to a much higher level, the creation of banking credit (including that required by the Government) would have been checked, prices would have fallen, and a large portion of the surplus notes have come back for cancellation. In this way an effective gold standard would have been maintained in spite of the heavy issue of notes. But during the war conditions have not been normal. The public are content to employ Currency Notes for internal purposes, and, notwithstanding adverse exchanges, war conditions interpose effective practical obstacles against the export of gold. Moreover, the legal prohibition of the melting of gold coin, and the fact that the importation of gold bullion is reserved to the Bank of England, and that dealings in it are limited have severed the

[1] The notes issued by Scottish and Irish banks which have been made legal tender during the war have not been included in the foregoing figures. Strictly the amount (about £5,000,000) by which these issues exceed the amount of gold and Currency Notes held by those banks should be added to the figures of the present fiduciary issues given above.

link which formerly existed between the values of coin and of uncoined gold. It is not possible to judge to what extent legal tender currency may in fact be depreciated in terms of bullion. But it is practically certain that there has been some depreciation, and to this extent therefore the gold standard has ceased to be effective.

RESTORATION OF CONDITIONS NECESSARY TO THE MAINTENANCE OF THE GOLD STANDARD RECOMMENDED

15. We shall not attempt now to lay down the precise measures that should be adopted to deal with the situation immediately after the war. These will depend upon a variety of conditions which cannot be foreseen, in particular the general movements of world prices and the currency policy adopted by other countries. But it will be clear that the conditions necessary to the maintenance of an effective gold standard in this country no longer exist, and it is imperative that they should be restored without delay. After the war our gold holdings will no longer be protected by the submarine danger, and it will not be possible indefinitely to continue to support the exchanges with foreign countries by borrowing abroad. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be very grave danger of a credit expansion in this country and a foreign drain of gold which might jeopardize the convertibility of our note issue and the international trade position of the country. The uncertainty of the monetary situation will handicap our industry, our position as an international financial centre will suffer, and our general commercial status in the eyes of the world will be lowered. We are glad to find that there was no difference of opinion among the witnesses who appeared before us as to the vital importance of these matters.

CESSATION OF GOVERNMENT BORROWINGS

16. If a sound monetary position is to be re-established and the gold standard to be effectively maintained, it is in our judgment essential that Government borrowings should cease at the earliest possible moment after the war. A large part of the credit expansion arises, as we have shown, from the fact that the expenditure of the Government during the war has exceeded the amounts which they have been able to raise by taxation or by loans from the actual savings of the people. They have been obliged therefore to obtain money through the creation of credits by the Bank of England and by the Joint Stock Banks, with the result that the growth of purchasing power has exceeded that of purchasable goods and services. As we have already shown, the continuous issue of uncovered currency notes is inevitable in such circumstances. This credit expansion (which is necessarily accompanied by an evergrowing foreign indebtedness) cannot continue after the war without seriously threatening our gold reserves and, indeed, our national solvency.

17. A primary condition of the restoration of a sound credit position is the repayment of a large portion of the enormous amount of Government securities now held by the banks. It is essential that as soon as possible the State should not only live within its income but should begin to reduce its indebtedness. We accordingly recommend that at the earliest possible moment an adequate sinking fund should be provided out of revenue, so that there may be a regular annual reduction of capital liabilities, more especially those which constitute the floating debt. We should remark that it is of the utmost importance that such repayment of debt should not be offset by fresh borrowings for capital expenditure. We are aware that immediately after the war there will be strong pressure for capital expenditure by the State in many forms for reconstruction purposes. But it is essential

to the restoration of an effective gold standard that the money for such expenditure should not be provided by the creation of new credit, and that, in so far as such expenditure is undertaken at all, it should be undertaken with great caution. The necessity of providing for our indispensable supplies of food and raw materials from abroad and for arrears of repairs to manufacturing plant and the transport system at home will limit the savings available for new capital expenditure for a considerable period. This caution is particularly applicable to far-reaching programmes of housing and other development schemes.

The shortage of real capital must be made good by genuine savings. It cannot be met by the creation of fresh purchasing power in the form of bank advances to the Government or to manufacturers under Government guarantee or otherwise, and any resort to such expedients can only aggravate the evil and retard, possibly for generations, the recovery of the country from the losses sustained during the war.

Use of Bank of England Discount Rate

18. Under an effective gold standard all export demands for gold must be freely met. A further essential condition of the restoration and maintenance of such a standard is therefore that some machinery shall exist to check foreign drains when they threaten to deplete the gold reserves. The recognized machinery for this purpose is the Bank of England discount rate. Whenever before the war the Bank's reserves were being depleted, the rate of discount was raised. This, as we have already explained, by re-acting upon the rates for money generally, acted as a check which operated in two ways. On the one hand, raised money rates tended directly to attract gold to this country or to keep here gold that might have left. On the other hand, by lessening the demands for loans for business purposes, they tended to check expenditure and so to lower prices in this country, with the result that imports were discouraged and exports encouraged, and the exchanges thereby turned in our favour. Unless this two-fold check is kept in working order the whole currency system will be imperilled. To maintain the connection between a gold drain and a rise in the rate of discount is essential to the safety of the reserves. When the exchanges are adverse and gold is being drawn away, it is essential that the rate of discount in this country should be raised relatively to the rates ruling in other countries. Whether this will actually be necessary immediately after the war depends on whether prices in this country are then substantially higher than gold prices throughout the world. It seems probable that at present they are on the whole higher, but, if credit expansion elsewhere continues to be rapid, it is possible that this may eventually not be so.

Continuance of Differential Rates for Home and Foreign Money not Recommended

19. It has been argued before us that during the period of reconstruction, and perhaps for many years afterwards, it will be possible and desirable, even though the exchanges are adverse, to keep money for home industry substantially cheaper in this country than it is abroad and yet retain an effective gold standard by continuing the present practice of differentiating between home money and foreign money. It is held that relatively low rates should be offered for home money and charged on domestic loans, while gold is at the same time prevented from going abroad by the offer of high rates for foreign money. In our judgment, so soon as the present obstacles in the way of international intercourse are removed, any attempt to maintain this differentiation must break down because it would be impracticable to prevent people from borrowing at the low home rate and contriving in one way or another to re-lend at the high foreign rate. This could only be

prevented, if at all, by the maintenance of such stringent restrictions upon the freedom of investment after the war as would, in our opinion, be most detrimental to the financial and industrial recovery of this country. Even, however, if differentiation, as a post-war policy, were practicable, it would not, in our judgment, be desirable. For the low home rate, by fostering large loans and so keeping up prices, would continue to encourage imports and discourage exports ; so that, even though the high rate offered for foreign money prevented gold from being drawn abroad, it would only do this at the cost of piling up an ever-growing debt from Englishmen to foreigners. It would be necessary at the same time to continue to pay for our essential imports of raw materials by borrowing in the United States and elsewhere, instead of by increasing our exports, thus imposing further burdens of foreign debt. This process could not continue indefinitely, and must sooner or later lead to a collapse. We are, therefore, of opinion that the need for making money dear in the face of adverse exchanges cannot, and should not, be evaded by resort to differential rates.

Legal Limitation of Note Issue Necessary

20. The foregoing argument has a close connection with the general question of the legal control of the note issue. It has been urged in some quarters that in order to make possible the provision of a liberal supply of money at low rates during the period of reconstruction further new Currency Notes should be created, with the object of enabling banks to make large loans to industry without the risk of finding themselves short of cash to meet the requirements of the public for legal tender money. It is plain that a policy of this kind is incompatible with the maintenance of an effective gold standard. If it is adopted there will be no check upon the outflow of gold. Adverse exchanges will not be corrected either directly or indirectly through a modification in the general level of commodity prices in this country. On the contrary, as the issue of extra notes stimulates the conditions which tend to produce an advance of prices, they will become steadily more and more adverse. Hence the processes making for the withdrawal of our gold will continue and no counteracting force will be set in motion. In the result, the gold standard will be threatened with destruction through the loss of all our gold.

21. The device of making money cheap by the continued issue of new notes is thus altogether incompatible with the maintenance of a gold standard. Such a policy can only lead in the end to an inconvertible paper currency and a collapse of the foreign exchanges, with consequences to the whole commercial fabric of the country which we will not attempt to describe. This result may be postponed for a time by restrictions on the export of gold and by borrowing abroad. But the continuance of such a policy after the war can only render the remedial measures which would ultimately be inevitable more painful and protracted. No doubt it would be possible for the Bank of England, with the help of the Joint Stock Banks, without any legal restriction on the Note Issue, to keep the rate of discount sufficiently high to check loans, keep down prices, and stop the demand for further notes. But it is very undesirable to place the whole responsibility upon the discretion of the banks, subject as they will be to very great pressure in a matter of this kind. If they know that they can get notes freely, the temptation to adopt a lax loan policy will be very great. In order, therefore, to ensure that this is not done, and the gold standard thereby endangered, it is, in our judgment, imperative that the issue of fiduciary notes shall be, as soon as practicable, once more limited by law, and that the present arrangements under which deposits at the Bank of England may be exchanged for legal tender currency without affecting the reserve of the Banking Department shall be terminated at the earliest possible moment. Additional demands for legal tender currency otherwise than in exchange for gold should be met

from the reserves of the Bank of England and not by the Treasury, so that the necessary checks upon an undue issue may be brought regularly into play. Subject to the transitional arrangements as regards Currency Notes which we propose in paragraphs 43 to 46, and to any special arrangements in regard to Scotland and Ireland which we may have to propose when we come to deal with the questions affecting those parts of the United Kingdom, we recommend that the Note Issue (except as regards existing private issues) should be entirely in the hands of the Bank of England; the notes should be payable in gold in London only, and should be legal tender throughout the United Kingdom.

Machinery for the Control of the Note Issue

22. So far we have addressed ourselves to the principles upon which the retention and maintenance of an effective gold standard depend. We have now to consider the particular machinery in regard to the control of the Note Issue by which the observance of these principles can most effectively be secured, and what modification (if any) may be desirable or permissible in the system in force before the war.

23. We would in the first place observe that, while the obligation to pay both Bank of England notes and Currency Notes in gold on demand should, in our judgment, be maintained, it is not necessary for the maintenance of an effective gold standard, nor do we think it desirable that there should be an early resumption of the internal circulation of gold coin. For the present at any rate we think that it will be more economical that gold should be held in a central reserve as a backing for notes in circulation. We do not think that any legislation on this subject will be required. People have by now become fully accustomed to the use of notes, and it is probable that (except for the limited requirements of persons proposing to travel abroad) they will continue to circulate instead of gold coin much as they do at present. Informal action on the part of the banks may be expected to accomplish all that is required. If necessary, however, the circulation of gold coin could be prevented by making the notes convertible at the discretion of the Bank of England either into such coin or into bar gold, though for our own part we should prefer to maintain the right of the note-holder to receive payment in gold coin and to trust to the informal steps suggested above to prevent gold from flowing into internal circulation.

24. Secondly, while it is a necessary condition of an effective gold standard that the import of gold should be free from all restrictions, it is not necessary to allow gold coin or bullion obtained otherwise than from the Bank of England to be exported. In view of the fact that it is convenient that the Bank of England should have cognizance of all gold exports, we think it desirable that the export of gold coin or bullion should be subject to the condition that such coin or bullion has been obtained from the Bank for the purpose. Manufactured gold should be deemed to be bullion unless it is in the form of articles containing a prescribed fashion value (say of 10 per cent.). The Bank should be under obligation to supply gold for export in exchange for its notes. These conditions will be sufficient to enable parity to be maintained between currency and bullion, since importers of gold will be free to sell it either in the market or to the Bank of England.

25. Thirdly, in view of the withdrawal of gold from circulation, it is, we think, desirable that the gold reserves of the country should be held by one central institution, and we recommend therefore that all banks should transfer any gold now held by them to the Bank of England, except such small amounts as they may require to keep for the convenience of travellers.

In our opinion, the prohibition against the melting of gold coin should for the present be maintained.

26. We have carefully considered various proposals that have been laid before us as regards the basis upon which the fiduciary note issue should in

future be fixed. It has been urged that the raising of the discount rate by the Bank of England may be delayed too long to check effectively an undue expansion of credit, and that under the rigid restrictions of the Act of 1844 a famine of legal tender money might ensue. Crises of this nature necessitating the suspension of the Act arose in 1847, 1857, and 1866, and on the first two occasions notes were actually issued by the Bank in excess of the maximum authorized by law. On this ground mainly it has been urged that these rigid restrictions ought to be transformed into something more elastic. To this end the following principal proposals, either separately or in combination, have been put before us by various witnesses—

(1) That the Banking and Issue Department of the Bank of England should be amalgamated;

(2) That the issue of additional notes, instead of being required to be covered £ for £ by gold, should be freely allowed, subject only to the condition that a prescribed percentage of the total issue should be so covered;

(3) That, while either an absolute figure for the maximum fiduciary issue or a maximum determined on a proportionate basis should be prescribed by law, provision should be made for increases beyond this maximum upon condition of a tax being paid by the Bank to the Government.

These various suggestions we now proceed to discuss.

27. First, the main effect of the amalgamation of the two Departments of the Bank of England would be to place deposits with the Bank of England in the same position as regards convertibility into gold as is now held by the note. It has been argued in favour of this change that greater security would be given to the deposits than under the present system. After careful consideration we are unable to recommend it. The deposits have at present the full security of the reserve in the Banking Department, and it is obvious that any such additional security would be at the direct expense of the security of the note. In our opinion it is desirable that the issue of Currency shall be subject to strict legal regulation, but that the management of banking should be left as free as possible from State interference. We think that the amalgamation of the two Departments would inevitably lead in the end to State control of the creation of banking credit generally, a contingency which we are convinced would greatly hamper the elasticity and efficiency with which the banks are able to meet the requirements of industry.

28. Secondly, the proposal to allow the issue of fiduciary notes without limit, subject only to a fixed percentage of the total issue being held in gold by the Bank of England (or the Issue Department of the Bank of England if there is no amalgamation), appears to us objectionable for the following reasons. If, as happened in general in the German Reichsbank, other regulations keep the actual note issue much below the maximum fixed by this proportion, the proportion is not effective and produces no result. But, if the actual note issue is really controlled by the proportion, the arrangement is liable to bring about very violent disturbances. Suppose, for example, that the proportion of gold to notes is actually fixed at one-third and is operative. Then, if the withdrawal of gold for export reduces the proportion below the prescribed limit, it is necessary to withdraw notes in the ratio of three to one. Any approach to the conditions under which the restriction would become actually operative would thus be likely to cause even greater apprehension than the limitations of the Act of 1844.

29. This consequence might no doubt be obviated for a time if the Joint Stock Banks themselves kept large reserves of gold and were prepared in the event of the depletion of the Bank of England reserve either by an external or by an internal drain to use them to make good the depletion and so dispense for the time being with the necessity for withdrawing notes from circulation. It is clear, however, that unless the same steps in regard to money rates and the restriction of credit were taken as would be necessary if the depletion were actually operative, this remedy would be merely a temporary palliative,

since the causes which had occasioned the drain would continue to operate unchecked. If, on the other hand, as some have advocated, the banks were given in consideration for their assistance in such contingencies, in addition to the right to obtain notes for the gold brought in, the right to receive advances in further fiduciary notes, the result, so far as the right was exercised, would be to neutralize the effect which the gold brought in would otherwise have had in preserving or restoring the proportion of gold to circulation, while the Bank of England would be placed in the very dangerous position of being under an absolute obligation to create new credits at the very moment at which a policy of credit restriction had become essential.

Incidentally we would remark that the minimum percentage proposed by the London Chamber of Commerce, namely, 33⅓ per cent. of gold against the Bank of England note issue and 20 to 25 per cent. against a separate issue of Currency Notes, would in our opinion be wholly inadequate. The percentage of gold to the two issues, taken together, would actually be less than is now held. The Manchester Chamber of Commerce propose that the proportion of gold to notes should be 40 per cent., while Sir Edward Holden was of opinion that the Bank should aim at that proportion of gold in respect to its total liabilities on account of the notes issued and deposits. For the reasons indicated above, however, we have come to the unanimous conclusion that there are substantial objections to basing the note issue of this country upon any proportionate holding of gold.

30. There remains, thirdly, the plan of fixing a maximum *absolute* limit to the fiduciary note issue, subject to the condition that this limit may be exceeded on the payment of a tax to the Government. It is obvious that, if such a tax is to act as a deterrent, it must be sufficiently high to secure that no profit should accrue to the Bank as the result of the emergency issue. As this profit necessarily depends to a large degree upon the rate of interest at which accommodation is given to the market, we do not think, in view of the great uncertainty as to the future course of interest rates, that it is practicable now to name any figure which could safely be adopted for such a tax. Unless it is fixed at a sufficiently penal rate to secure that the normal fiduciary issue is not exceeded except in circumstances of real emergency, and then only for a strictly limited period, the system may afford dangerous possibilities of excessive speculation and lend itself to the development of crises which more stringent safeguards might have averted altogether. This criticism has in fact been made of the German plan, and we are not clear how the arrangements recently adopted by the United States, which have not yet been tested by experience, will actually operate. If it were decided to adopt any such method in this country, it would be necessary for safety to take a very high rate which might in fact prove to be unduly penal.

31. In view of the comparison with the systems prevailing in foreign countries which have been put forward by various witnesses, we would point out that these countries have not in practice maintained the absolutely free gold market which this country, by reason of the vital importance of its position in international finance, is bound to do. It has therefore been open to them to have recourse to devices to steady the rate of discount which, even if successful for this purpose, it would be inexpedient and dangerous for us to attempt.

Maintenance of Principle of Bank Charter Act, 1844, Recommended

32. Having regard to the foregoing considerations, we are of opinion that the principle of the Act of 1844, which has upon the whole been fully justified by experience, should be maintained, namely, that there should be a fixed fiduciary issue beyond which, subject to emergency arrangements which we recommend below, notes should only be issued in exchange for gold. It is

noteworthy that from 1866 till the outbreak of the present war no suspension of the Act was ever necessary. We think that the stringent principles of the Act have often had the effect of preventing dangerous developments, and the fact that they have had to be temporarily suspended on certain rare and exceptional occasions (and those limited to the earlier years of the Act's operation when experience of working the system was still immature) does not, in our opinion, invalidate this conclusion. We recommend, therefore, that the separation of the Issue and Banking Departments of the Bank of England should be maintained and that the Weekly Return should continue to be published in its present form.

Modification of Provisions of Act of 1844 in respect of Issue of Emergency Currency Recommended

33. This conclusion, however, has not prevented us from considering with care the possibility of so modifying the Act of 1844 as to make provision for the issue of emergency currency in times of acute difficulty. It might, no doubt, be sufficient to leave matters as they were prior to 1914 and to risk the possibility of the law having to be broken, subject to indemnity from Parliament, but upon the whole we share the objections which have been expressed in many quarters to this procedure. We are therefore of opinion that the provisions of Section 3 of the Currency and Bank Notes Act, 1914, under which the Bank of England may, with the consent of the Treasury, temporarily issue notes in excess of the legal limit, should be continued in force. It should be provided by statute that Parliament should be informed forthwith of any action taken by the Treasury under this provision by means of a Treasury Minute which should be laid before both Houses. The statute should also provide that any profits derived from the excess issue should be surrendered by the Bank to the Exchequer. It will, of course, be necessary that the Bank Rate should be raised to, and maintained at, a figure sufficiently high to secure the earliest possible retirement of the excess issue.

34. In connection with these emergency arrangements we have considered the question of the reserves which should be held by the Joint Stock Banks quite apart from their normal reserves of legal tender money. As we do not contemplate a resumption of the internal circulation of gold, no useful purpose would be served by their accumulating gold which can be more effectively employed by the Bank of England in maintaining the exchanges and supporting the note issue. We have considered a proposal that they should be required to hold a certain proportion of their deposits in the form of Treasury Bills and other short-dated Government Securities, which, in the event of a crisis, might be discounted with the Bank of England and form the basis of an issue of emergency currency if required. While we think it expedient that such reserves should be held, we have come to the conclusion that it would not be desirable to attempt any legal regulation of the matter. Our attention has, however, been called to the fact that a Committee of Bankers have recommended that banks should in future be required to publish a Monthly Statement in the form of Appendix I to this Report showing the average of their weekly balance sheets, during the month. We entirely concur in this recommendation and we suggest that the statement of assets should be amplified by the addition after "money at call and at short notice" of a heading "Government Securities maturing within 12 months." If this is done, we think that the consequent publicity will be amply sufficient to secure the object which we have in view.

Amount of Fiduciary Note Issue and Gold Reserve

35. Having come to the conclusion that the amount of the fiduciary issue should, subject to what was said in paragraph 33, be fixed by law at some definite amount, we have next to consider how large this fiduciary issue ought to be.

Assuming the restoration of an effective gold standard, and given the

conventional standards of banking practice and the customs of the public as regards the use of currency, the amount of legal tender currency (other than subsidiary coin) which can be kept in circulation, including the currency holdings of the banks and the Banking Department of the Bank of England, will determine itself automatically, since, if the currency becomes redundant, the rate of discount will fall, and prices will rise; notes will be presented in exchange for gold for export and the volume of the currency will be reduced *pro tanto*. If, on the other hand, the supply of currency falls below current requirements, the rate of discount will rise, prices will fall, gold will be imported, and new notes taken out in exchange for it.

36. Under the arrangements which we contemplate virtually the whole amount of the currency gold in the country will be held in a central reserve at the Bank of England; and the circulation, in the wide sense in which we are using the term, will consist (apart from the subsidiary currency, which we need not now consider) in part of fiduciary notes, and, as regards the balance, of notes covered by that reserve. The total circulation being automatically determined, it will follow that the higher the amount fixed for the fiduciary issue the lower will be the amount of the covered issue and, consequently, of the central gold reserve and *vice versa*, while, if the fiduciary issue were fixed at a figure which proved to be higher than the total requirements of the country for legal tender currency, the covered issue, and with it the central gold reserve, would disappear altogether. It is clear, therefore, that the amount of the fiduciary issue must be fixed at a figure low enough to make sure, not merely that there will always be some covered issue, but that there will always be a covered issue of sufficiently substantial amount to secure that the covering gold which constitutes the central reserve never falls so low as to give rise to apprehension as to the stability of the gold standard.

37. If the post-war requirements proved to be no larger than the pre-war requirements (about £180,000,000, exclusive of subsidiary coin, as shown in paragraph 13), it is clear that the present fiduciary issue of £249,000,000 would have to be reduced by £69,000,000 before any gold could be retained in the central reserve at all. Even upon the supposition that the policy of substituting notes for all gold outside that reserve is completely successful, in order to have a central gold reserve of £100,000,000 the fiduciary issue would have to be reduced to £80,000,000 and, even so, we should have £60,000,000 less gold in the country than before the war.

38. The pre-war requirements, however, had relation to the level of pre-war world prices, the existing conventional standards in regard to banking reserves, and the habits of the people, both in regard to the amounts of money which they carried in their pockets and kept in their homes and to the use of credit instruments in place of cash. It is probable that after the war world prices will stand for many years, if not permanently, at a greatly enhanced level, and that the banks may well find it desirable to adopt a higher standard for their holdings of legal tender money. Furthermore, any additional economy in the use of legal tender money which may take place through the extended use of bankers' cheques and other credit instruments may be more than offset by the fact that a larger share of the national income is likely to be enjoyed by the wage-earning classes who are the chief users of legal tender money. All these causes will tend to increase the amount of legal tender money which the country will, consistently with the maintenance of a gold standard, be able to retain in bank reserves and general circulation to a point much above the pre-war figure, but the precise amount of the increase can only be determined by experience.

39. Until such experience has been gained it would in our opinion be dangerous to seek to lay down any precise figure for the fiduciary issue. The adoption of an unnecessarily low figure would result in the accumulation of a gold reserve of larger dimensions than is strictly necessary for the protection of the gold standard and the security of our national credit—a luxury

which we shall be ill able to afford in the difficult times which are ahead—while the adoption of too high a figure would destroy the gold standard altogether.

40. It therefore seems desirable to approach the problem from the other end, and to attempt to fix tentatively the amount which we should like to see held in gold in the central reserve, leaving the ultimate dimensions of the fiduciary issue to be settled as the result of experience at the amount of fiduciary notes which can be kept in circulation—in banking reserves (including the Banking Reserve of the Bank of England), and in the pockets of the people—without causing the central gold reserve to fall appreciably below the amount so fixed.

41. The pre-war gold reserves were about £38,500,000 in the Bank of England and an amount estimated at £123,000,000 in the banks and in the pockets of the people. If the actual circulation of gold coin ceases and the whole of the gold is concentrated in the central institution, some economy is permissible in view of its increased mobility. On the other hand the aggregate amount of currency required will undoubtedly be larger. We accordingly recommend that the amount to be aimed at in the first instance as the normal minimum amount of the central gold reserve should be £150,000,000, and that, until this amount has been reached and maintained concurrently with a satisfactory foreign exchange position for a period of at least a year, the policy of reducing the uncovered note issue as and when opportunity offers should be consistently followed. In view of the economic conditions which are likely to follow the restoration of peace, it will be necessary to apply this policy with extreme caution and without undue rigidity. When the exchanges are working normally on the basis of a minimum reserve of £150,000,000 the position should again be reviewed in the light of the dimensions of the fiduciary issue as it then exists.

Reduction of Present Currency Note Issue During Interim Period

42. If these arrangements are adopted, there will be an interim period beginning after the completion of demobilization during which it is probable that the present issue of Currency Notes will have to be gradually reduced until experience has shown what amount of fiduciary notes can be kept in circulation consistently with the maintenance of this reserve. It was suggested to us in evidence that, until that amount has been ascertained, steps should be taken as soon as possible after the war to reduce the uncovered issue at the rate of not less than 3 per cent. per annum of the outstanding amount, and that, subject to arrangements for meeting a temporary emergency, the issue in any period of six months or one year should not be allowed to exceed the amount outstanding in the preceding similar period. We think that it would be highly desirable to aim at a steady and continuous reduction, but we are disposed to doubt whether it will be found to be practicable to work to any precise rule. We confine ourselves therefore to the general recommendation of policy indicated above. We entirely concur, however, in the suggestion that, when reductions have taken place, the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements proposed in paragraph 33.

Transitional Arrangements Pending Replacement of Currency Note Issue by a Bank of England Issue

43. It remains for us to consider how and when the present issue of Currency Notes is to be replaced by the Bank of England issue. There would be some awkwardness in transferring the issue to the Bank of England before the future dimensions of the fiduciary issue have been ascertained. We, therefore, recommend that during the transitional period the issue should remain a

Government issue, but that such post-war expansion (if any) as may take place should be covered, not by the investment of the proceeds of the new notes in Government Securities, as at present, but by taking Bank of England Notes from the Bank and holding them in the Currency Note reserve, and that, as and when opportunity arises for providing cover for the existing fiduciary portion of the issue, the same procedure should be followed. The effect of this arrangement would be that the demands for new currency would operate in the normal way to reduce the reserve in the Banking Department at the Bank of England, which would have to be restored by raising money rates and encouraging gold imports.

44. We should thus in course of time have the Currency Note issue covered partly by the £28,500,000 of gold at present held and partly by Bank of England notes covered by gold in the Issue Department of the Bank of England; the balance, forming the fiduciary part of the issue properly so-called, being covered by Government Securities as at present. During the transition stage the greater part at any rate of the demand for gold for export will fall upon the Bank of England, since Currency Notes are not likely to be presented to any large extent for actual payment in gold, but will be paid in by the banks which collect them to the credit of their accounts with the Bank of England, the balances thereby created being used when necessary to draw gold from the Bank of England for export in the ordinary way. We accordingly think that it will be desirable that Bank of England notes should likewise be substituted in the Currency Note reserve, either immediately after the war or from time to time by instalments, for the £28,500,000 in gold now held by that reserve, so that when the time is ripe for the final transfer the whole of the gold reserve may be in the hands of the Bank.

45. When the fiduciary portion of the issue has been reduced to the amount which experience shows to be consistent with the maintenance of a gold reserve of £150,000,000 in the Issue Department of the Bank, the outstanding Currency Notes should be retired and Bank of England notes of low denomination substituted, the Bank of England fiduciary issue being simultaneously increased by an amount equal to the then issue of Currency Notes covered by Government securities. As the Bank of England notes held in the Currency Note reserve and the gold against them would already appear in the Bank return, the only effect on that return of the ultimate merger would be to add to the total Bank of England issue the amount of the fiduciary portion of the Currency Note issue as ultimately ascertained, and to add the same amount of Government securities to the securities in the Issue Department.

46. The settlement as between the Treasury and the Bank would take the form of the Treasury handing over to the Bank in exchange for a like amount of Currency Notes withdrawn by the Bank from circulation the Bank of England notes held for the Currency Note account, and in respect of the remainder of the Currency Notes withdrawn, Government Securities. These securities should be either Ways and Means advances or Treasury Bills and other marketable securities being part of the ordinary Public Debt, and should be taken at current market value. In so far as any of the assets of the Currency Note redemption account at the time of transfer might not come within these categories they should be retained by the Treasury and other securities substituted. The Bank of England notes of small denomination would be issued by the Bank in place of the Currency Notes withdrawn from circulation, partly in substitution for the Bank of England notes returned to them from the Currency Note Reserve (which would be already covered by gold in the Issue Department), and partly in respect of the Bank's new fiduciary issue based on the transferred securities. The profits of the increased fiduciary issue would be payable by the Bank to the Exchequer.

Summary of Conclusions

47. Our main conclusions may be briefly summarized as follows—

Before the war the country possessed a complete and effective gold standard.

The provisions of the Bank Act, 1844, operated automatically to correct unfavourable exchanges and to check undue expansions of credit. (Pars, 2 to 7.)

During the war the conditions necessary to the maintenance of that standard have ceased to exist. The main cause has been the growth of credit due to Government borrowing from the Bank of England and other banks for war needs. The unlimited issue of Currency Notes has been both an inevitable consequence and a necessary condition of this growth of credit. (Pars. 8 to 14.)

In our opinion it is imperative that after the war the conditions necessary to the maintenance of an effective gold standard should be restored without delay. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be grave danger of a progressive credit expansion which will result in a foreign drain of gold menacing convertibility of our note issue and so jeopardizing the international trade position of the country. (Par. 15.)

The pre-requisities for the restoration of an effective gold standard are –

(*a*) The cessation of Government borrowing as soon as possible after the war. We recommend that at the earliest possible moment an adequate sinking fund should be provided out of revenue, so that there may be a regular annual reduction of capital liabilities, more especially those which constitute the floating debt. (Pars. 16 and 17.)

(*b*) The recognized machinery, namely, the raising and making effective of the Bank of England discount rate, which before the war operated to check a foreign drain of gold and the speculative expansion of credit in this country, must be kept in working order. This necessity cannot, and should not, be evaded by any attempt to continue differential rates for home and foreign money after the war. (Pars. 18 and 19.)

(*c*) The issue of fiduciary notes should, as soon as practicable, once more be limited by law, and the present arrangements under which deposits at the Bank of England may be exchanged for legal tender currency without affecting the reserve of the Banking Department should be terminated at the earliest possible moment. Subject to transitional arrangements as regards Currency Notes and to any special arrangements in regard to Scotland and Ireland which we may have to propose when we come to deal with the questions affecting those parts of the United Kingdom, we recommend that the Note Issue (except as regards existing private issues) should be entirely in the hands of the Bank of England. The notes should be payable in London only, and should be legal tender throughout the United Kingdom. (Pars. 20 and 21.)

As regards the control of the Note Issue, we make the following observations—

(1) While the obligation to pay both Bank of England Notes and Currency Notes in gold on demand should be maintained, it is not necessary or desirable that there should be any early resumption of the internal circulation of gold coin. (Par. 23.)

(2) While the import of gold should be free from all restrictions, it is convenient that the Bank of England should have cognizance of all gold exports, and we recommend that the export of gold coin or bullion should be subject to the condition that such coin and bullion has been obtained from the Bank for the purpose, The Bank should be under obligation to supply gold for export in exchange for its notes. (Par. 24.)

(3) In view of the withdrawal of gold from circulation we recommend that the gold reserves of the country should be held by one central institution and that all banks should transfer any gold now held by them to the Bank of England. (Par. 25.)

Having carefully considered the various proposals which have been placed before us as regards the basis of the fiduciary note issue (pars. 26 to 31), we recommend that the principle of the Bank Charter Act, 1844, should be

maintained, namely, that there should be a fixed fiduciary issue beyond which notes should only be issued in exchange for gold. The separation of the Issue and Banking Departments of the Bank of England should be maintained, and the Weekly Return should continue to be published in its present form. (Par. 32.)

We recommend, however, that provision for an emergency be made by the continuance in force, subject to the stringent safeguards recommended in the body of the Report, of Section 3 of the Currency and Bank Notes Act, 1914, under which the Bank of England may, with the consent of the Treasury, temporarily issue notes in excess of the legal limit. (Par. 33.)

We advocate the publication by the banks of a monthly statement in a prescribed form. (Par. 34.)

We have come to the conclusion that it is not practicable to fix any precise figure for the fiduciary Note Issue immediately after the war. (Pars. 35 to 39.)

We think it desirable, therefore, to fix the amount which should be aimed at as the central gold reserve, leaving the fiduciary issue to be settled ultimately at such amount as can be kept in circulation without causing the central gold reserve to fall below the amount so fixed. We recommend that the normal minimum of the central gold reserve to be aimed at should be, in the first instance, £150,000,000. Until this amount has been reached and maintained concurrently with a satisfactory foreign exchange position for at least a year, the policy of cautiously reducing the uncovered Note Issue should be followed. When reductions have been effected, the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements previously recommended. When the exchanges are working normally on the basis of a minimum reserve of £150,000,000, the position should again be reviewed in the light of the dimensions of the fiduciary issue as it then exists. (Pars. 40 to 42.)

We do not recommend the transfer of the existing Currency Note Issue to the Bank of England until the future dimensions of the Fiduciary Issue have been ascertained. During the transitional period the issue should remain a Government issue, but new notes should be issued, not against Government Securities, but against Bank of England Notes, and, furthermore, when opportunity arises for providing cover for existing uncovered notes, Bank of England Notes should be used for this purpose also. Demands for new currency would then fall in the normal way on the Banking Department of the Bank of England. (Pars. 43 and 44.)

When the fiduciary portion of the issue has been reduced to an amount which experience shows to be consistent with the maintenance of a central gold reserve of £150,000,000, the outstanding Currency Notes should be retired and replaced by Bank of England Notes of low denomination in accordance with the detailed procedure which we describe. (Pars. 45 and 46.)

We have the honour to be,
My Lords and Sir,
Your obedient Servants,
(Signed) CUNLIFFE (*Chairman*).
C. S. ADDIS.
R. E. BECKETT.
JOHN BRADBURY.
G. C. CASSELS.
GASPARD FARRER.
HERBERT C. GIBBS.
W. H. N. GOSCHEN.
INCHCAPE.
R. W. JEANS.
A. C. PIGOU.
GEO. F. STEWART
W. WALLACE.

G. C. UPCOTT (*Secretary*).
15th August, 1918.

PROPOSED MONTHLY STATEMENT TO BE PUBLISHED BY BANKS

Statement of the average figures of the weekly Balance Sheets during the month of________________19___

LIABILITIES.			ASSETS.		
Capital—			Cash—	£	
Registered £			(1) Coin, Bank and Currency Notes and Balances with the Bank of England £		
Subscribed £			(2) Balances with London Clearing Agents and with other Banks, Bankers, or Banking Companies in the United Kingdom – £		
Paid up . . . £			(3) Items in transit . . £		
Reserve Fund			Money at Call and at Short Notice		
Current, Deposit, and other Accounts			British Bills of Exchange . .		
Acceptances			Foreign Bills, Foreign Bank Bills, and Domiciled Bills . .		
Endorsements, Guarantees, and other obligations . . .			Balances abroad. . . .		
Notes in Circulation . . .			Investments—		
			(1) Securities of, or guaranteed by, British Government .		
			(2) Indian and Colonial Government Securities, British Corporation Stocks, British Railway Debenture and Preference Stocks		
			(3) Other Investments . .		
			Loans and Advances . .		
			Other Assets		
			Bank Premises		
			Liabilities of Customers for Acceptances, as per contra . .		
			Liabilities of Customers for Endorsements, Guarantees, and other obligations, as per contra. .		
£			£		

APPENDIX XI

FINAL REPORT OF THE COMMITTEE ON CURRENCY AND FOREIGN EXCHANGES AFTER THE WAR

TERMS OF APPOINTMENT

THE Lords Commissioners of His Majesty's Treasury and the Minister of Reconstruction have appointed a Committee to consider the various problems which will arise in connection with currency and the foreign exchanges during the period of Reconstruction and report upon the steps required to bring about the restoration of normal conditions in due course.

The constitution of the Committee will be as follows—

LORD CUNLIFFE, G.B.E., Governor of the Bank of England, *Chairman.*
SIR CHARLES ADDIS, Hong-Kong and Shanghai Banking Corporation.
THE HON. RUPERT BECKETT, Beckett and Company.
SIR JOHN BRADBURY, K.C.B., Secretary to the Treasury.
G. C. CASSELS, ESQ., Bank of Montreal.
GASPARD FARRER, Esq., Baring and Company.
THE HON. HERBERT GIBBS, Antony Gibbs and Sons.

W. H. N. GOSCHEN, Esq., Chairman of the Clearing Bankers' Committee.
LORD INCHCAPE OF STRATHNAVER, G.C.M.G., K.C.S.I., K.C.I.E.
R. W. JEANS, Esq., Bank of Australasia.
A. C. PIGOU, Esq., M.A., Professor of Political Economy, Cambridge University.
G. F. STEWART, Esq., D.L., F.S.I., Ex-Governor of the Bank of Ireland.
WILLIAM WALLACE, Esq., Royal Bank of Scotland.
Mr. G. C. UPCOTT, of the Treasury and Ministry of Reconstruction, will act as Secretary to the Committee.

January, 1918.

The following words were subsequently added to the Terms of Reference—

"and to consider the working of the Bank Act, 1844, and the constitution and functions of the Bank of England with a view to recommending any alterations which may appear to them to be necessary or desirable."

On his appointment as Principal British Reparation Commissioner, Sir John Bradbury resigned from the Committee. Mr. B. P. Blackett, C.B., the Controller of Finance, Treasury, was appointed a member of the Committee in his place.

Mr. Cassels was prevented by absence in Canada from attending the later meetings of the Committee.

Mr. H. E. Fass, of the Treasury, was appointed in July, 1919, Joint Secretary with Mr. Upcott to the Committee.

TO THE LORDS COMMISSIONERS OF HIS MAJESTY'S TREASURY

MY LORDS—

1. We have the honour to present herewith our Final Report on certain matters referred to us in January, 1918, with which we were not in a position to deal in our Interim Report in August of that year.

2. *Foreign Exchanges.*—We stated in the introduction to our Interim Report our opinion that a sound system of currency would in itself secure equilibrium in the Foreign Exchanges. We have reviewed the criticisms which have been made upon this part of our Report, but we see no reason to modify our opinion. We have found nothing in the experiences of the war to falsify the lessons of previous experience that the adoption of a currency not convertible at will into gold or other exportable coin is likely in practice to lead to over-issue and so to destroy the measure of exchangeable value and cause a general rise in all prices and an adverse movement in the foreign exchanges.

3. The nominal convertibility of the Currency Note which has been sustained by the prohibition of the export of gold is of little value. The weakness of the exchanges is in a measure due to trade conditions, but an important cause of the depreciation in sterling in New York and other financial centres is, in our opinion, to be found in the expanded state of credit in this country. The existing expansion is not merely the legacy of the stress of war finance and Government borrowings, which even now have not ceased, but also, in part the result of maintaining rates for money in London below those ruling in other important financial centres. The difficulties of the Foreign Exchanges' position are aggravated by the grant of long term loans and credits, whether directly or under guarantee or otherwise by the Government or by private lenders, to enable foreign States or their nationals to pay for exports from this country. Few of these loans and credits will be liquidated at an early date. The large payments which we have to make to America, North and South, for necessary imports of foodstuffs and raw materials from those countries, make it essential that we, in our turn, should secure payment in

cash for as large a proportion as possible of our exports, visible and invisible. We recommend therefore that preference should be given to exports to countries which are able to make payment in the ordinary course of trade.

Increased production, cessation of Government borrowings, and decreased expenditure both by the Government and by each individual member of the nation are the first essentials to recovery. These must be associated with the restoration of the pre-war methods of controlling the currency and credit system of the country for the purpose of re-establishing at an early date a free market for gold in London.

4. *Bank of England.*—The principles of the Bank Charter Act of 1844 were fully considered by us in our Interim Report. We have examined with care the opinions there expressed in the light of certain criticisms which have been made with regard to them. We see, however, no reason to alter our conclusions. We have again considered the principles governing the banking systems of the principal foreign countries and we are satisfied that they are not so well adapted to the needs of this country as those contained in the Act of 1844. Certain important alterations which experience suggested to be desirable have been made in the constitution and management of the Bank during the war, and we do not now think it necessary to make any further recommendation.

5. *Government Borrowings on Ways and Means Advances from the Bank of England.*—We desire to draw attention to the extensive use made during the war of the system of Ways and Means Advances from the Bank of England. We referred to this matter in paragraph 16 of our Interim Report and explained its effect in causing credit and currency expansion. The powers given to the Government by Parliament to borrow from the Bank of England in the form of an overdraft on the credit of Ways and Means were, as the name implies, intended to enable the Government to anticipate receipts from Revenue or permanent borrowings for a brief period only. Indeed, Parliament, by expressly providing that all such advances should be repaid in the quarter following that in which they were obtained, showed that it had no intention of bestowing upon the Government the power of securing an overdraft of indefinite duration and amount. Under the exigencies of war finance the Government found it necessary to re-borrow in each quarter on the credit of Ways and Means the amount needed to enable them to comply with the statutory requirement that the previous quarter's Ways and Means Advances should be repaid, with the result that the total outstanding advances remained for a long time at a high figure. We are glad to see that efforts are now being made to reduce this overdraft to more moderate dimensions.

We, therefore, hope now that conditions are less abnormal, that the Government will confine its use of Ways and Means and Advances from the Bank of England to providing for purely temporary necessities. Such advances afford a legitimate method of tiding over a few weeks' shortage, but are entirely unsuitable for borrowings over a longer period.

6. *Foreign Banks.*—Several of our witnesses have called attention to the conditions under which it is open to foreign banks to establish themselves in this country. We suggest that this is a matter which should receive the early attention of His Majesty's Government.

7. *Scottish and Irish Banks.*—We have now taken evidence in regard to the application of the recommendations in our Interim Report to Scotland and Ireland. The status of legal tender was given to the notes of the Scottish and Irish Banks of Issue as an emergency measure to tide over the period at the outbreak of war when a serious shortage of currency was threatened, a condition of affairs which no longer obtains. Some of the witnesses on behalf of the Scottish and Irish Banks showed a marked desire to retain the privilege of legal tender status for their notes. In our opinion, the grant of legal tender status could not be given permanently to the notes of Scottish and Irish Banks except under statutory conditions similar to those embodied

in the Bank Act of 1844. The evidence before us indicates that rather than be subjected to such conditions the banks would prefer the restoration of the pre-war status. We accordingly recommend that the pre-war status be restored. We further recommend that when the position which we contemplate in our Interim Report is ultimately reached the cover held by the Scottish and Irish Banks for their excess issue shall take the form of any legal tender at that time in existence.

8. *Currency Note Issue.*—We have considered whether steps should not be taken at an early date to impose limitations upon the fiduciary portion of the Currency Note issue with a view to the restoration of the normal arrangements under which demands for new currency operate to reduce the reserve in the Banking Department of the Bank of England. In view of the fact that demobilization is approaching completion and that, as we hope, fresh Government borrowing will shortly cease, we consider that effect should now be given to the recommendation made in our Interim Report that the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements which we proposed in paragraph 33 of our Interim Report. The policy of placing Bank of England Notes in the Currency Note Reserve as cover for the fiduciary portion of the issue as opportunity arises should, of course, be continued. We recommend further that the Treasury Minute made under Section 2 of the Currency and Bank Notes Act, 1914, providing for the issue of Currency Notes to Joint Stock Banks, which is in fact inoperative, should now be withdrawn.

The Committee wish to place on record their deep sense of obligation to Mr. G. C. Upcott, who served as Secretary to the Committee from the beginning with unfailing zeal, knowledge, and ability. They are also greatly indebted to Mr. H. E. Fass, who was appointed Joint Secretary with Mr. Upcott, in July, 1919, and rendered important and efficient service in the closing period of the Committee's labours.

We have the honour to be,
My Lords,
Your obedient Servants,
(Signed) CUNLIFFE (*Chairman*).
C. S. ADDIS.
R. E. BECKETT.
BASIL P. BLACKETT.
GASPARD FARRER.
HERBERT C. GIBBS.
W. H. N. GOSCHEN.
INCHCAPE.
R. W. JEANS.
A. C. PIGOU.
[1]GEO. F. STEWART.
W. WALLACE.

G. C. UPCOTT }
H. E. FASS } *Secretaries.*

3rd December, 1919.

[1] Subject, as regards the recommendations of paragraph 7, to the following reservation—

Having regard to the evidence given by the witnesses from Ireland, the pre-war status should not be restored in Ireland until the Government consider the time opportune.

(Signed) GEO. F. STEWART.

APPENDIX XII

DECLARATION BY THE SUPREME COUNCIL OF THE PEACE CONFERENCE ON THE ECONOMIC CONDITIONS OF THE WORLD

(As Approved by the Supreme Council on 8th March, 1920)

The Supreme Council of the Peace Conference has taken into consideration the causes which combine to produce the present high cost of living, and now thinks it desirable to publish the following declaration—

1. *General Statement of the Position.*—The war which the democracies of Western Europe were forced to undertake in defence of their liberties, and which they have carried to a triumphant conclusion, has necessarily entailed the disorganization of the whole economic position of Europe.

This disorganization is reflected in the rise of prices which is at present the source of universal discontent among the peoples, belligerent and neutral alike. History shows that high prices are the inevitable result of war, and in comparison with most wars the present situation is far from abnormal. In the Napoleonic wars, prices in England rose 75 per cent., and took eight years to become normal again. In the American Civil War American prices rose 100 per cent. and took twelve years or more to become normal. As the result of this war, the most gigantic of all in the history of the world, general wholesale prices (as distinct from the cost of living) have advanced since 1913 approximately as follows—

The United States .	120 per cent.
Great Britain . .	170 ,,
France	300 ,,
Italy	300 ,,
Belgium . . .	300 ,,

Many causes contribute to this rise in prices, but they may all be regarded as directly or indirectly the consequences of war. For nearly five years the energies of the people have been diverted from the work of production to the work of destruction; for nearly five years the creation of new resources has been stopped and the resources of past generations consumed or destroyed. To feed and equip the nations engaged in this struggle, their Governments had to mortgage the prospective wealth of their countries in the form of credits or paper money. The excessive creation of these tokens of prospective wealth, as compared with the volume of real wealth, is indicated by the rise in prices.

Nothing but the hard necessities of war could have justified or excused this procedure. Its dangers are obvious. Public appreciation of the necessity of maintaining a strict balance between normal revenue and expenditure is weakened, and the ordinary individual is misled by the illusion of prosperity to believe that there is an increase in *real* wealth and an abundance of available supplies, and is encouraged in habits of extravagance.

Government action may mitigate or disguise some of the effects of the rise in prices, but it cannot remove the root cause, which is the destruction of wealth. This loss of wealth is, after all, but a small matter compared with the sacrifice of life, which was freely given during the war to overthrow militarism and re-establish national liberty in Europe. But its effects can only be healed by the passage of time, and the people of Europe, if they wish to expedite the process, must contribute to the works of peace the same ardour and devotion as they gave to the prosecution of the war. In the subjoined review of the position the Conference indicates the lines on which it considers that a solution of the problem can best be found; but it is vain to expect that the result of the war can be eliminated by a stroke of the pen.

2. *Peace not yet Re-established.*—At present Europe is far from having

returned to the conditions of complete peace. Russia is stated to have in the field armies of 1,500,000 men or more, and the disbandment of these armies is, of course, a primary condition of European peace. But many also of the countries which have been created or enlarged as the outcome of the war have still the appearance of armed camps; and not less than 1,000,000 men are still under arms in Poland, Roumania, and the new States created out of Austria-Hungary. Moreover, although armed conflict has ceased, the mutual rivalries and antipathies which are the natural legacy of war still dominate many of the nations of Europe, and are leading to the erection of artificial economic barriers which must seriously hamper, if they do not entirely prevent, the restoration of the common prosperity.

The first step to the reconstruction of Europe is to complete the process of demobilization in all countries, to resume the full employment in peaceful pursuits of the whole of the able-bodied population and to encourage by every means the normal interchange of their products. Until peaceful conditions have thus been resumed in every branch of life, Europe, which has suffered so terribly during the past years of strife, will continue to suffer from the restlessness and lack of confidence which is the natural consequence of the upheaval through which she has passed.

3. *Increase of Production.*—Liberty has, indeed, been preserved to Europe, and the threat of military domination is gone. This great achievement has, however, left victors and vanquished alike impoverished and enfeebled. Death or disablement has removed from the work of production millions of men in the prime of life; and millions more have had their efficiency impaired by sufferings on the field of battle or through pestilence or privations at home. Instead of having the assistance of these sons, each country has to provide, in the most generous measure possible, for the maintenance of the maimed and for the families of the fallen, and this must for many years to come be the first charge on the national income. Meanwhile those who remain have not yet recovered the former habit of industry, and have not yet re-adjusted their standard of output to compensate for the reduction of hours which public opinion in all countries has demanded and is securing. At the same time, of the machinery which might have made good these deficiencies much has been destroyed, and more has been worn out, no adequate renewals being possible during the war. In particular, all means of transport have been disorganized, and the efficiency of the railway systems has been universally impaired.

To these general losses must be added the special disturbances of production in each country. For example, a large portion of the most fertile territory, more especially in France and in the North of Italy, has been devastated; while in France also industrial centres and mining areas, of vital importance to her industries, have been completely destroyed and will not be able to resume production for years to come. In Belgium, similarly, the national industries suffered greatly during the period of occupation. Germany, on the other hand, has its industrial establishments intact, but is paralysed by lack of capital and credit, and by the disorganization bred of defeat; while in the case of Austria these conditions have led to the complete breakdown of her economic life. Russia has passed through all the throes of civil strife, and is still the victim of confusion and anarchy. Each country suffers from a different difficulty, but each contributes its share to the common deficit.

In agriculture, Russia, which before the war was the most important granary of Europe, and of whose products Europe is in such need, either has not been producing at all or has not been able to exchange with her neighbours such products as she has.

Roumania, which before the war exported annually over 6,000,000 quarters of wheat, has altered her system of land tenure, and is now ceasing to produce more than suffices for the immediate needs of her own population; indeed, on the 1st December last, it was stated that only 530,000 hectares had been sown as compared with an annual average before the war of 1,000,000 hectares,

though some improvement has since taken place. Other countries again, such as France and Germany, which were largely self-supporting, are unable at the present moment, owing to the devastation of the land, the destruction of buildings and machinery, or the lack of capital and fertilizers, to produce more than a fraction of what is required for their own needs, and have been increasingly driven to compete in the world market for the limited supplies now available.

Again, in regard to coal, production in every country has been decreased, the approximate figures of output in metric tons for 1913 and 1919 respectively being as follows—

	1913.	1919.
United Kingdom . . .	292,000,000	234,000,000
France (including Lorraine).	44,000,000	22,000,000
Germany[1] (excluding Saar and Lorraine) . . .	173,000,000	109,000,000
United States of America .	517,000,000	495,000,000

Although detailed statistics are not available, such information as we have goes to show that the output of factories and manufacturing industries throughout the world is below the standard which prevailed before the war, and far below the demands now made upon them. The net result of under-production arising from these various causes is an acute shortage of the essential supplies on which the economic life of Europe depends.

This situation requires to be met with the same courage as was displayed on both sides during the war. The energy which was then thrown into the production of foodstuffs must be revived and redoubled in order to restore the situation. It must be made a point of honour with the tillers of the soil in every country to show that peace can extract from nature more than war. Europe must take measures to provide herself more largely with the food she requires in order that she may resume her full activities, and much can be effected if the necessary preparations are made without delay.

In regard to industry generally, each Government must take steps to impress on its people that the limitation of production directly assists the upward movement of prices, and that it is by increasing production that they can best help to solve the problem. Every proposal which may assist in this direction deserves the closest attention.

Governments must co-operate in the reconstruction of the common economic life of Europe, which is vitally inter-related, by facilitating the regular interchange of their products and by avoiding arbitrary obstruction of the natural flow of European trade.

The Powers represented at the Conference re-affirm their determination to collaborate with a view to the execution of these aims.

4. *Increase of Consumption.*—Meanwhile, instead of restricting the standard of consumption in view of this shortage of supplies, there is a general tendency to make heavier and heavier demands for the limited quantities of goods that are available. The increase of consumption takes the form of an intensified demand for commodities of every description. The demand not only for foodstuffs, but for clothing, boots, and other manufactured articles, is in most countries far in excess of the supply, while luxuries of every kind command a readier sale than at almost any previous period.

The general extravagance now observable throughout the world is a phenomenon which has almost invariably followed in the footsteps of every great human catastrophe. It is well known to those who have lived in a district which has suffered from earthquake, and the history of the great plagues of Europe amply illustrates it; and the results have always been economically disastrous for the populations affected. It must be one of the first aims of each Government to take such measures as appear appropriate

[1] Exclusive of lignite.

to the circumstances of its own people to bring home to every citizen the fact that for the time being, until supplies are increased, it is by diminished consumption and unselfish denial that they are best able to help themselves and the world; and that extravagance increases the national difficulties and perils.

5. *Credit and Currency Inflation*.—The immense increase in the spending power of Europe which is reflected in this extravagance has been brought about by credit and currency inflation during the war. Broadly speaking, the general level of prices may be said to be the expression of the ratio between spending power on the one hand and the volume of purchasable goods and services on the other. In order to prosecute the war, particularly in European countries, every Government found it necessary to increase the amount of currency in circulation. Unable to raise sufficient funds by taxation and by loans from real savings, they were compelled to resort to borrowing from the banks and the use of the printing press. Additional spending power was thus placed in the hands of the public at a time when the volume of purchasable goods was being reduced. For example, the note circulation has grown approximately as follows—

In the United Kingdom from £30,000,000 in 1913 to nearly £450,000,000 at the end of 1919. (About £120,000,000 of the latter figure takes the place of gold coins in circulation in 1913);

In France[1] from £230,000,000 in 1913 to £1,500,000,000 in 1919;

In Italy[1] from £110,000,000 in 1913 to £700,000,000 in 1919;

In Belgium[1] from £40,000,000 in 1913 to £200,000,000 in 1920;

While the war debts (which are closely connected with inflation) amount, in the case of the United Kingdom, to over £7,000,000,000;

In France[1] to £6,750,000,000;

In Italy[1] to £2,750,000,000;

In Germany[1] (apart from liabilities for reparation) to £9,500,000,000;

In the United States[1] to £5,000,000,000.

The total war debt of the world is approximately £40,000,000,000.

Throughout Europe, prices at present are, with few exceptions, paper prices. But gold prices have also risen, that is to say, gold has a lower purchasing power than it had before the war. This is the inevitable result of the many economies which have been effected in the use of gold for monetary purposes, and, on the other hand, of the dispersal of stocks of gold previously held in Europe and their excessive accumulation in other countries. Thus, in the United States, although the gold standard remains effective, prices have advanced 120 per cent. over the pre-war level. As the purchasing power of gold is ultimately the measure of price, it must be obvious that this change is itself responsible for much of the increase in the price of commodities, when expressed in terms of the currencies of all countries.

A considerable part of the rise in prices in Europe is due to this depreciation of gold, but there is an additional depreciation due to excessive issues of paper currency. The continual expansion of paper issues with its necessary consequence of continuously depreciating exchange prevents the grant of the commercial credits required by the situation, and thus fatally hampers the resumption of international commerce.

It is essential to the recovery of Europe that the manufacture of additional paper money and Government credits should be brought to an end, and this must be effected as soon as the war expenditure has been terminated.

6. *Profiteering*.—Excessive profit-making, commonly known as profiteering, has resulted from the scarcity of goods. Deflation and a check upon the continuous rise of prices will do much in itself to end the conditions that make profiteering possible. But it is essential, in order to obtain the

[1] NOTE.—The national currencies have in each case been converted into sterling at approximately par of exchange.

co-operation of all classes in the increase of production, that each Government should take such steps as are appropriate to the circumstances of its own people to assure and guarantee to the workers that the burdens that they are called upon by their efforts to remedy are not aggravated by those who would exploit the economic difficulties of Europe for their own personal ends.

7. *Restriction of Government Expenditure.*—Demobilization has been effected by the Powers represented at the Conference at a far speedier rate than could have been anticipated, but heavy abnormal expenditure resulting from the war still requires to be met (particularly in connection with the restoration of the devastated areas). Such charges must be regarded as part of the war burden, but in order to stop the process of inflation and to start the process of deflation, the necessary measures must be initiated by every country to balance recurrent Government expenditure with national income and to begin at the earliest possible moment the reduction of the floating debts. The best remedy of all is that debts should be reduced out of revenue, but in so far as this is not possible, floating debts should be consolidated by means of long term loans raised out of the savings of the people, and it is out of the savings of the people that any fresh capital expenditure must be provided. The Governments here represented have undertaken the consideration of the measures required for this purpose.

8. *Restriction of Private Expenditure.*—But private economy is not less urgent than economy in Government expenditure. It is only by means of frugal living on the part of all classes of the nation that the capital can be saved which is urgently required for the repair of war damage, and for restoring efficiency to the equipment of industry, upon which future production depends. It is of the utmost importance that it should be brought home to every citizen in each country that just as in the war their private savings made available for the Government goods and services urgently needed for the prosecution of hostilities, so in the period of reconstruction, economy by individuals will reduce the cost of essential articles both for themselves and for their fellows, and will set free capital for the reconstruction of their country and the restoration of the machinery of industry throughout the world.

9. *Collapse of Exchanges.*—Commercial intercourse, on the resumption of which the recovery of the world depends, is governed by the foreign exchanges, and most of the foreign exchanges have been to a greater or less extent disorganized during the past year. The discount of European currencies on New York approximately stands as follows—

Pound sterling . .	30 per cent.
Franc (Paris) . .	64 ,,
Franc (Brussels) . .	62 ,,
Lire	72 ,,
Mark	96 ,,

The state of the exchanges does not reflect the true financial situation of the countries concerned, provided their industrial life can be resumed. It is in part the result of depreciation in the purchasing power of the several currencies, but in part it results from the failure of exports. Many countries are temporarily dependent on the importation of food, raw material, and other necessaries, and are not in a position to export nearly sufficient to furnish the requisite means of payment. The result has been severe competition for the very limited supply of bills of exchange which has forced down the rate of exchange beyond the point which properly represents the purchasing power of currencies in the buying and selling countries. In the degree in which rates of exchange are so forced down, the prices of imports are forced up and the prices of food and raw material increased. The ultimate cure is to raise exports to the requisite amount, and this should be impressed on

the trading communities affected, but it is not immediately possible to increase exports sufficiently, and unless steps are taken to furnish a substitute the situation will rapidly become worse. It is therefore urgent to obtain a temporary balance of trade by means of commercial credits accompanied by the reduction of all non-essential imports to an absolute minimum.

10. *Difficulties of Credit.*—Attempts to manipulate the exchanges by Government action will only retard ultimate recovery. Meanwhile, means must be found to prevent the breakdown of trading operations. At the present moment, the Governments of Europe are not in a position to furnish more Government loans, except to a very limited extent for the purpose of relieving extreme distress, and State aid in this matter would be at the best entirely inadequate. It is from the resumption of commercial credits that the necessary means must be found for securing the interchange of the resources of the world, and the Conference is assured that such credits will be forthcoming as soon as Governments have taken steps to strengthen confidence in their commercial and financial policy.

The Powers represented at the Conference recognize, however, the necessity of continued collaboration in this matter, and they will continue to consult together regarding the provision and distribution of the necessary raw materials and foodstuffs with a view to the early resumption of normal conditions.

They recognize, further, the special position of the devastated countries, and particularly of France, having regard to the widespread devastation which her territory has suffered, the consequent diminution of her immediate resources, and the heavy capital expenditure which she must incur in restoring the damaged areas. The restoration of the devastated areas is of primary importance to the reconstruction of Europe.

They have also had under consideration the special position of Germany, where enterprise is at present paralyzed and the possibility of obtaining commercial credit closed, by reason of the fact that her obligations for reparation are still totally unknown. It is most desirable, therefore, in the interests of the Allied Countries, no less than in that of Germany, that at the earliest possible moment the total of the reparation payments to be made by Germany under the Treaty of Versailles should be fixed, and that, in accordance with the terms of the Treaty and the reply of the Allied and Associated Powers to the German delegates dated the 16th June, 1919, she should be enabled to obtain essential foodstuffs and raw materials, and, if necessary in the opinion of the Reparation Commission, should be allowed to raise abroad a loan to meet her immediate needs, of such amount and with such priority as the Reparation Committee may deem essential. In the case of Austria, the Powers here represented recognize that even more active assistance may require to be given.

11. *Need for Co-operation of all Classes.*—The review which the Conference has made of the situation indicates that the process of recovery of Europe must necessarily be a slow one, which cannot be expedited by short-cuts of any description. It can, however, be most seriously hampered by the dislocation of production by strikes, lock-outs, and interruptions of work of all kinds. The civilization of Europe has indeed been shaken and set back, but it is far from being irretrievably ruined by the tremendous struggle through which she has passed. The restoration of her vitality now depends on the whole-hearted co-operation of all her children, who have it in their own power to delay or to accelerate the process of reconstruction. It is the hope of every Government that improved conditions of livelihood and of employment may be assured to the workers. To secure this result, each individual must contribute his best efforts to the restoration of his country. Taking the Allied Countries as a whole, the recovery of industry has been remarkable. Nearly eighteen months have passed since hostilities terminated, and the reaction which necessarily followed the tense strain of the war is

gradually passing. The citizens of every country are once again resuming the normal occupations of home life, and in their renewed labours the Conference sees a clear sign of renewed prosperity.

12. *Summary of Conclusions.*—In view of the above considerations, the Supreme Council, after a careful survey of this vitally urgent problem in all its aspects, agree upon the following recommendations with a view to the amelioration of the present economic difficulties of Europe—

(1) It is of paramount importance that peace conditions should be fully and completely restored at the earliest possible moment throughout the world. In order to achieve this object it is desirable—

(*a*) That peace and normal economic relations should be re-established as soon as possible throughout Eastern Europe;

(*b*) That armies should everywhere be reduced to a peace footing, that armaments should be limited to the lowest possible figure compatible with national security, and that the League of Nations should be invited to consider, as soon as possible, proposals to this end;

(*c*) That the States which have been created or enlarged as the result of the war should at once re-establish full and friendly co-operation, and arrange for the unrestricted interchange of commodities in order that the essential unity of European economic life may not be impaired by the erection of artificial economic barriers.

(2) Not only the Government of each country, but all those engaged in the task of production in every land, should give immediate attention to the execution of all measures which will contribute to the full resumption of peaceful industry, to the encouragement of better output on the part of the workers in every country, to the improvement of machinery and means of transportation, and the removal of such disturbing factors as profiteering.

(3) Each Government should at once consider means for urging upon its nationals in every rank of life the vital necessity of suppressing extravagance and reducing expenditure, so as to bridge the gap which must for some years exist between the demand for and the supply of essential commodities.

(4) It is essential that early steps be taken to secure the deflation of credit and currency (*a*) by the reduction of recurrent Government expenditure within the limits of revenue, (*b*) by the imposition of such additional taxation as is necessary to secure this result, (*c*) by the funding of short-term obligations by means of loans subscribed out of the savings of the people, and (*d*) by the immediate limitation and gradual curtailment of the note circulation.

(5) The provision of raw materials being essential to the restoration of industry, means should be found by which the countries which are in present conditions of international exchange unable to purchase in the world markets, and so are unable to re-start their economic life, can obtain commercial credits. It will be possible to achieve this when the countries have made the reforms indicated in the foregoing paragraphs.

(6) The Powers represented at the Conference recognize the necessity for continued co-operation between the Allies and for removing obstacles to the easy interchange of essential commodities. They will continue to consult together regarding the provision and distribution of necessary raw materials and foodstuffs with a view to the early restoration of normal conditions.

(7) The Powers represented at the Conference have given careful attention to the special case of the devastated regions, and more particularly of Northern France. The restoration of these areas is of primary importance for the re-establishment of the economic equilibrium of Europe and the resumption of normal trade conditions. It is evident that the large sums required for this purpose cannot be provided out of current revenue, nor

can the work of restoration be postponed until the reparation due from Germany under the Treaty of Peace has been received. Under these circumstances the Powers represented at the Conference recognize that the capital sums required for this restoration may properly be raised by market loans in anticipation of the reparation payments provided by the Treaty, and that the restrictions which they desire to see placed on new borrowing do not apply to loans and credits raised for the purpose of meeting this abnormal capital expenditure.

(8) The Powers represented at the Conference have taken under consideration Article 235 and cognate articles of the Treaty of Versailles, and the passages in the letter addressed on the 16th June, 1919, by the Supreme Council to the German Peace Delegates, which contemplates that Germany shall make proposals for fixing the total of the payments to be made by her by way of reparation, and that facilities may be given her to obtain necessary foodstuffs and raw materials in advance of payments being made by way of reparation. The Powers are agreed that it is desirable in the interest alike of Germany and of her creditors that the total to be paid by her for reparation should be fixed at an early date. They observe that under the Protocol to the Treaty a period of four months from the signature of the Treaty was provided during which Germany should have the right to make proposals of the kind referred to, and they are agreed that in the circumstances as they exist to-day such period should be extended.

2 WHITEHALL GARDENS, S.W.1,
8th March, 1920.

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